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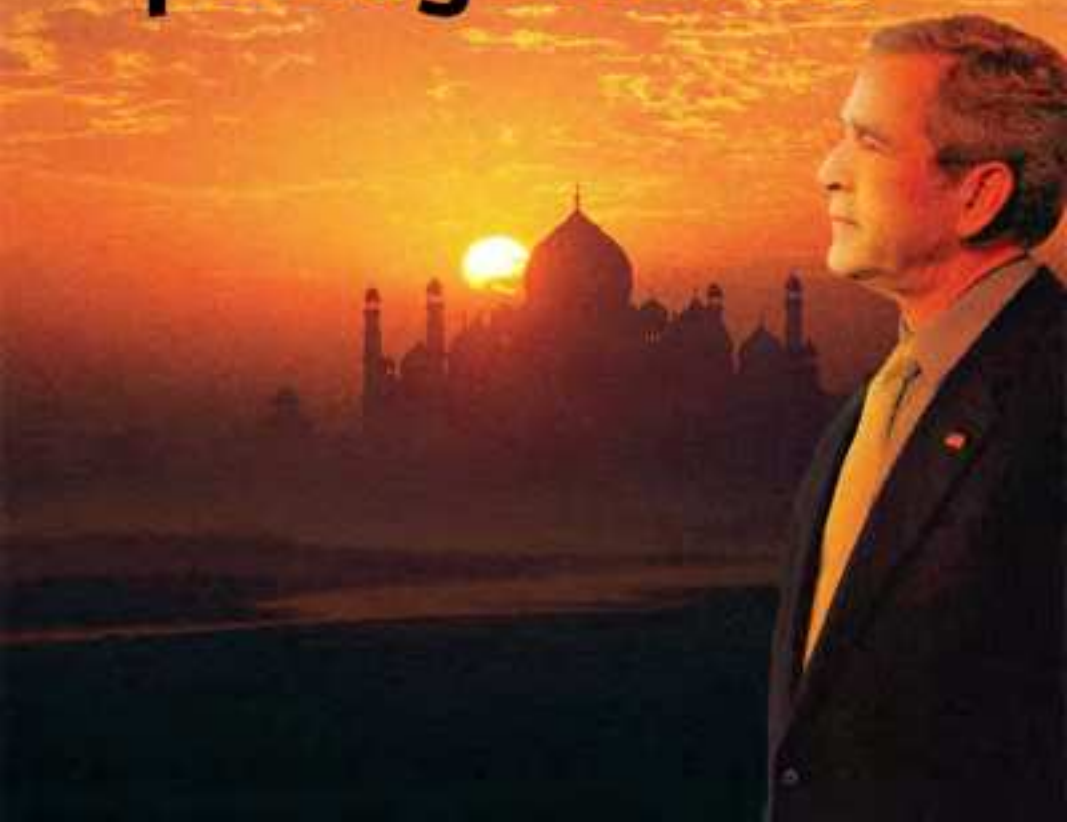
George Bush's passage to India



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Print Edition — February 25th 2006

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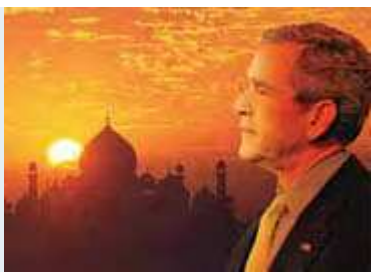

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Politics this week

Feb 23rd 2006
From The Economist print edition

Reuters

A new **Palestinian** parliament was sworn in, with the Islamist movement, Hamas, providing 74 of its 132 members. Israel halted the transfer of customs and tax revenue to the Palestinian Authority, saying that a Hamas-run government would be a terrorist one. The Americans and Europeans continued efforts to press Hamas to, among other things, recognise Israel and renounce violence. See article

Iraq's insurgent bombers, presumed to be Sunni extremists, severely damaged the Askariya shrine, the fourth-holiest to Iraqi Shias, in the city of Samarra. The outrage sparked lethal sectarian reprisals, which resulted in scores of deaths, making it harder for the majority Shias to build a unity government. See article

The American secretary of state, Condoleezza Rice, visited **Egypt**, where she met—among others—liberal opponents of President Hosni Mubarak's regime and urged him once again to democratise his country's politics. He recently postponed local elections due in April. See article

Ms Rice urged the American Congress to give some $75m to boost opposition to the clerical regime in **Iran**, $20m of it to groups based mainly in exile, the rest to media and internet projects to undermine the mullahs. See article

President George Bush said that NATO forces should be used to help the UN take over from the African Union in its failing effort to keep the peace in **Sudan's** ever-bloody western region of Darfur. See article

Bloodshed continued or spread in at least three different parts of **Nigeria**. Rebels in the oil-rich Delta region kidnapped nine foreign oil-workers and caused oil companies to block off a fifth of Nigeria's oil exports. Rioters in the mainly Muslim north, riled by the Danish cartoons lampooning the Prophet Muhammad, burned churches and killed Christians, whereupon Christians in the east burned down mosques and killed at least a score of Muslims in reprisal. See article

Ports in a storm

Both Democrats and Republicans raised security concerns about giving DP World, a state-backed company based in Dubai, a role in running six **ports in the United States**. DP World recently bought Britain's P&O, which operates facilities in the ports. The Bush administration, which has approved the deal, says that DP World will comply with mandatory security measures. See article

South Dakota's legislature passed a stringent bill that bans abortion in most cases. Proponents of the law are hoping the Supreme Court (which earlier said it would look at the status of federal partial-birth abortion legislation) will take up the issue and reconsider *Roe v Wade*.

Three men from **Ohio** were charged with plotting against coalition troops in Iraq. It is thought to be the first time that suspects in America have faced indictments on attempting to aid the Iraqi insurgency.

Larry Summers said he would step down as president of **Harvard University**. Mr Summers's brief tenure was marked by controversy, most notably over comments on the role of women in science, causing a backlash from academics over his management. See article

Roger Ferguson said he is resigning his post as vice-chairman at the **Federal Reserve**, less than a month after Ben Bernanke took over the reins as chairman of the central bank.

Few good men

The head of **Colombia's** army resigned over a “hazing” scandal in which 21 young recruits were allegedly branded and sexually abused by senior officers at a base in the town of Piedras. President Álvaro Uribe condemned the misconduct, which didn't involve the army chief, as “deplorable”.

Relatives waited for news of the fate of 65 coal miners trapped underground after a gas explosion in the **Mexican** state of Coahuila.

AFP

Migration watch

The new strain of **bird flu** from Asia spread right across Europe. Seven countries have now confirmed cases, including Germany, France and Italy. The French and Dutch were authorised by the European Union to vaccinate some of their poultry. See article

Formal talks on the future status of **Kosovo**, the southern Serbian province that is now run by the UN, began in Vienna. Observers expect the province to gain independence despite objections from Serbia.

Serbia was engulfed by unconfirmed rumours that **Ratko Mladic**, the wartime Bosnian Serb general, had been arrested. He has been indicted for war crimes and crimes against humanity by the war-crimes tribunal based in The Hague. See article

A controversial British historian, **David Irving**, was sentenced by an Austrian court to three years' imprisonment for the crime of Holocaust denial, even though he pleaded guilty and said that he now admitted that the mass murder of Jews had taken place. See article

Three British bankers lost their appeal against the government to avoid **extradition** to the United States on Enron-related fraud charges. The “NatWest three” deny the charges and say they should be tried in England. They will now appeal to the House of Lords. See article

Nicolas Sarkozy, the French interior minister, said that **anti-Semitism** was to blame for the kidnap, torture and death of a young French Jew, Ilan Halimi, perpetrated by a gang led by a Muslim immigrant from the Côte d'Ivoire.

Talking with Tigers

Sri Lankan officials and Tamil Tiger rebels began meeting in Geneva for their first direct talks in three years.

Jacques Chirac, the president of France, visited **India**. Unfortunately, so did bird flu. Mr Chirac said that he is supporting India's bid for a seat on the UN security council. George Bush will make his first visit to India in early March.

AP

A vast mudslide was feared to have killed more than 1,000 people on the island of Leyte in the **Philippines**. See article

The head of **Kazakhstan's** security service tendered his resignation after five of his officers were arrested on suspicion of the murder of a leading opposition politician.

Local news

Bill Emmott, editor of *The Economist*, announced that he is standing down after 13 years in the post, during which worldwide circulation has more than doubled to almost 1.1m. His successor will be chosen by the board of directors in March, subject to approval by the trustees.

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Business this week

Feb 23rd 2006
From The Economist print edition

Germany's **E.ON** launched a *euro*29.1 billion ($34.7 billion) bid (the largest ever in the utilities sector) for **Endesa**, a Spanish power provider. However, politicians in Spain took a frosty attitude towards the offer. A *euro*21 billion merger to create a national energy champion between Endesa and **Gas Natural**, a domestic rival, had recently gained approval (Endesa is fighting the merger). See article

Time Warner reached a settlement with **Carl Icahn**, a corporate raider who has been campaigning to replace the firm's board, oust its chief executive and break it into four pieces. Mr Icahn got some of what he wanted: the media conglomerate will increase a planned share buy-back from $5 billion to $20 billion, appoint two new independent directors and cut an extra $500m of costs. But executives in the media industry and elsewhere were relieved to see that Mr Icahn, a controversial scourge of senior managers, failed to force a break-up of the company. See article

In one of Australia's biggest takeover bids, **Alinta**, a gas distributor based in Perth, launched an A$8.9 billion ($6.6 billion) offer to merge with **Australian Gas Light**. AGL, from the east coast, is three times the size of Alinta and the combined company would supply nearly 40% of Australians with power.

Cadbury Schweppes reported that higher sales than expected had contributed to a 46% rise in net profit, to £765m ($1.4 billion), for 2005. The company, which controls around 10% of the world's confectionery market and also makes Dr Pepper soft drinks, has been the subject of recent takeover speculation.

No sale on exchange

Macquarie Bank ended its hostile bid for the **London Stock Exchange**. The Australian firm was not willing to increase its £1.5 billion ($2.7 billion) offer for the institution, which the LSE says was “ill considered”. During the bid the LSE doubled to £510m the cash it plans to return to shareholders.

Reto Francioni, the chief executive of **Deutsche Börse**, said the German exchange operator was ready to restart talks over a possible combination with **Euronext**, which runs several European exchanges. Mr Francioni has been reviewing Deutsche Börse's options for expansion since last year's failed bid for the LSE. See article

Merck won a federal court case brought against it over Vioxx, its anti-inflammatory drug, which it withdrew on safety grounds in 2004. Prosecutors in the case failed to establish a link between Vioxx and the death of a 53-year-old man in 2001. However, the pharmaceutical firm still faces thousands of lawsuits; some analysts have estimated Merck's potential liability at up to $50 billion.

Wal-Mart reported a 9.4% rise in net profit, to $11.2 billion, for the year ending January 31st. The world's biggest retailer, which also clocked up sales of $312.4 billion, recently said it was on track to open 1,500 new shops in America over the next few years. See article

Putting the boot in

After last summer's “bra wars” over textiles, the European Union appeared set to introduce restrictions on **shoe imports** from China and Vietnam. Countries such as Italy have been lobbying for the quotas: shoe imports from China to the EU rose by 300% in the nine months ending in October 2005 compared with the same period in 2004. See article

A computer-industry association, which includes IBM, Oracle and Sun Microsystems, lodged a fresh antitrust complaint against **Microsoft** to the European Union. The move is a blow to Microsoft, which has expended a lot of effort in trying to comply with the EU's landmark antitrust ruling against it in 2004.

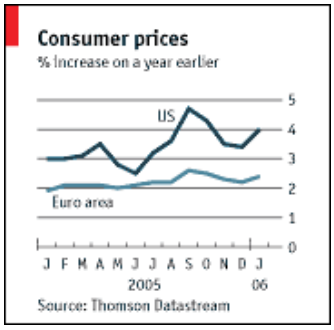
After a decade of lobbying, **Singapore Airlines'** bid for access to the lucrative Sydney to Los Angeles route was turned down by the Australian government. Rival Qantas, which dominates Australian routes to America, had fought hard against giving access, arguing that its profits would be hurt. However, the government, responding to grumbles over high fares, urged Qantas to forge an “alliance” with SA, and indicated it was warming to Virgin's

planned service on the route.

Peter Lim, the former head of finance at **China Aviation Oil**, was given a two-year jail sentence by a judge in Singapore for his part in a $550m derivatives scandal in 2004. Several other CAO executives are awaiting trial.

Bernanke's watching

America's headline **inflation** rate rose to 4% in January, a sharp increase from December's rate of 3.4% (the core inflation rate, which excludes food and energy, was down slightly at 2.1%). Economists pondered how the news might affect the Federal Reserve's policy on interest rates.



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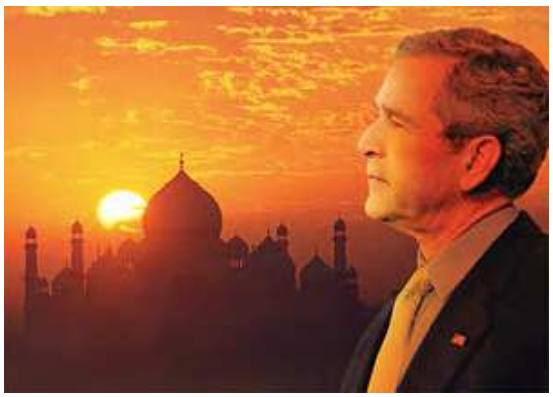
America and India

A passage to India

Feb 23rd 2006
From The Economist print edition

The pitfalls awaiting George Bush in the subcontinent



ON THE 13-hour flight next week from Washington to Delhi, George Bush could do a lot worse than to put aside his briefing books and curl up instead with E.M. Forster's best-known novel. “A Passage to India” is a tale, above all, of misunderstanding: of wrong signals, exaggerated expectations, offence unwittingly caused and taken, and inevitable disappointment. It is a parable of the complications that arise when eager Anglo-Saxons go travelling on the Indian subcontinent.

A degree of wide-eyed enthusiasm on Mr Bush's part is forgivable. India is a rich and exotic prize. Its booming high-tech service sector and tens of millions of affluent consumers have already convinced many of the world's business people that India is on the brink of replicating the astonishing burst of growth that transformed China from poor-house to power-house in little more than two decades. Add in the seductive fact that this “new China” is the world's largest democracy, and the arguments for forging a much closer partnership between India and America seem unassailable.

Rising India

It would not be before time, either. America has neglected India in the past. When Bill Clinton went to Delhi in 2000, his was the first presidential visit for 22 years, and it is surely not a good thing that Mr Bush has waited quite so long to make his own inaugural trip there. India is a nuclear power, home to more Muslims than any country but Indonesia; and it borders China, which many American policymakers see as at best a growing rival and at worst a future enemy. India is seldom regarded in the same way, even though it favoured the Soviet side in the cold war and even though Indian firms offer just as tough competition for parts of America's service sector as Chinese factories do to low-end manufacturing.

Despite all this, there are reasons (see article) to urge both sides to tread as carefully as angels before they rush in to an over-enthusiastic partnership. Mr Bush needs to avoid two kinds of mistake. The first, and most serious, would be to shower America's new friend with gifts that the United States can ill afford. Unfortunately, this has already happened. In July, when India's prime minister, Manmohan Singh, visited Washington, he came home with a remarkable present: a promise from Mr Bush that he would aim to share American civilian nuclear technology with India.

That was too generous. Under American and international law, such technology can be given only to countries that have renounced nuclear weapons and joined the Nuclear Non-Proliferation Treaty. India has never joined the treaty, and it tested nuclear weapons in 1998. Mr Bush, in effect, was driving a coach and horses through the treaty in order to suit his own strategic ends, a move that invites the accusation of hypocrisy from other nuclear states and wannabes not so favoured. The idea was that India, in return, should take steps to satisfy the Americans on a long list of nuclear-security concerns, such as not exporting weapons technology and continuing to observe a moratorium on testing. Most important, India was asked to separate its civilian and military nuclear

programmes, with the former subject to a rigorous inspection regime.

So far, however, the proposals offered by the Indians actually to do all this are far from adequate. As Mr Bush packs his bags, desperate attempts are being made to bridge the gap. The obvious danger is that in order to portray his summit as a success Mr Bush will be tempted to accept even fewer safeguards from India. That would be a dangerous mistake: nuclear proliferation matters too much to allow excessive wiggle-room or create bad precedents. Fortunately, whatever deal is agreed between Mr Bush and Mr Singh will also require the approval of America's Congress, which has already taken a dim view of Mr Bush's nuclear generosity to India.

Fearful China

Sending the wrong signal on nuclear weapons is not the only potential pitfall in America's romance with India. Mr Bush should also be wary of sending the wrong signal about America's intentions towards China. Too often when Indian-American relations are discussed in Washington, the notion is invoked that India might somehow turn out to be a “counterweight” to China. Yet it is hard to see, in practical terms, what sort of counterweight India could actually be. On the contrary, that sort of talk is liable only to reinforce China's fear that America's grand strategic design is to encircle it and block its rise as a great power. That fear has already been strengthened by America's recent transfer of some of its military might from the Atlantic to the Pacific.

The United States should not base its Asian strategy on that sort of balance-of-power diplomacy. Apart from anything else, India is far too canny, and cares too much about its own China relationship, to be drawn into such a game. Instead of encircling China, Mr Bush should concentrate on putting the American relationship with it on the right footing: deeper engagement, coupled with a determination to make China play by the rules. Yet Mr Bush's approach to this rising superpower has sometimes seemed almost casual: Hu Jintao, China's president, had been made to wait far too long for his state visit to Washington even before Hurricane Katrina forced him to cancel a visit last August. And Mr Bush has not worked hard enough at home to make the free-trade case against the protectionist hawks gunning for China (though, to be fair to him, he has not given them much comfort either).

Mr Bush must also take care to ensure that friendship with India does not damage his close ties to Pakistan, another American ally the president intends to visit on this trip. Pakistan is infinitely more fragile than India, but right now of much greater strategic significance to America. It is central to the fight against the remnants of al-Qaeda and the Taliban in Afghanistan. On top of that, it has an awful record of selling (by unauthorised freelancers, claims its government) nuclear-weapons technology on the open market. Pakistan's president, Pervez Musharraf, has lately shown signs of flexibility towards his country's long and dangerous dispute with India over Kashmir. But both countries need to show flexibility on Kashmir, and Mr Bush must take care not to tilt so far India's way that the Indians feel under no pressure to make concessions of their own. That will merely weaken Mr Musharraf and enfeeble a valuable American ally.

India itself has much to lose if its love-in with America goes wrong. For Mr Singh personally, the stakes are quite high. By backing American efforts to tackle Iran's nuclear ambitions, he has infuriated the left-wing parties on whose support his minority government depends, as well as some of his own party colleagues. If he cannot pull off a decent nuclear deal of his own, he will suffer for it. He is already learning that America's embrace is not the uncomplicated affair he might have hoped for. A visionary Indian project would see gas piped from Iran, via Pakistan. But as relations between America and Iran rapidly deteriorate, America is ever more reluctant to see it go ahead. Meanwhile, India's growing trade with America, whether in textiles or software services, is starting to run into a new generation of Asia-bashers in America. As E.M. Forster knew, no passage to India is ever entirely smooth.

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Avian flu

Ominous

Feb 23rd 2006
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Bird flu spreads around the globe

Reuters

FOR most of the past three years, the highly pathogenic bird flu known as H5N1 has been found mainly in Asia. Suddenly it has arrived in many countries in Europe, triggering widespread alarm. The detection of the virus in wild birds across Europe is certainly a cause for concern, particularly to Europe's poultry farmers, who are rightfully worried that the presence of the virus in wild birds will increase the risk to their flocks. However, in the midst of a European debate about the benefits of vaccinating chickens and whether or not poultry should be brought indoors, there is a danger that far more significant events elsewhere will be overlooked.

In particular, most attention should be focused on the fact that bird flu is now widespread in the poultry flocks of two nations in Africa—Egypt and Nigeria—and in India. And on the fact that, in Nigeria, the disease is continuing to spread despite great efforts undertaken by the government. An outbreak in Afghanistan also appears to be inevitable.

Arguably, these matter much more than the (also inevitable) arrival of the disease in Europe. Poor countries with large rural populations are in a far weaker position to handle, and stamp out, outbreaks of bird flu in poultry, through both culling and the prevention of the movement of animals in the surrounding areas. In Africa and India, chickens and ducks are far more likely to be found roaming in people's backyards, where they can mingle with humans, other domestic animals and wildlife, thus spreading the disease. In Europe, by contrast, most poultry are kept in regulated commercial farms.

The opening up of a new African front for the bird-flu virus is a problem because eradication there will be tremendously difficult. There is a high risk that the disease will spread to other countries on the continent and it could easily become endemic—as it has in Asia. This offers the virus huge new scope to mutate and become a disease that can pass between humans. The virus is certainly mutating—genetic changes have already affected its biological behaviour, although apparently not yet its transmission between humans. Experts are unsure as to how much, and what kind, of genetic changes would be required for the virus to become a global health threat. Nor do they know how long this process might take.

But to dwell on the increased risk of a pandemic of influenza is to miss a serious point about the direct risks posed by the loss of a large numbers of chickens and ducks across Africa. For some time, the United Nations Food and Agriculture Organisation has been warning that if avian flu gets out of control in Africa, it will have a devastating impact on the livelihoods of millions of people. Poultry is a vital source of protein. For example, it provides almost 50% of the protein in the diet of Egyptians. The spread of a disease that is highly lethal to poultry, and requires culling, could have a dire nutritional impact, there as elsewhere. Africa would also have to contend with huge economic losses. People who scratch out a living in poor African nations simply cannot afford to lose their chickens. Most of the world's poor live in rural areas and depend on agriculture. In Africa, rather a lot of these poor people depend heavily on their poultry. It is easy to see why some believe that bird flu could turn out to be primarily a development—rather than just a health—issue for the whole African continent.

No game of chicken

What can be done? It is clear that the movement and trade of poultry is making a big contribution to the spread of the virus (see article). That trade needs tighter regulation, as does the movement of live birds from countries with H5N1 infections. In such places trade should be suspended until flocks have been cleaned up.

In addition, Nigeria and surrounding countries need serious public-education campaigns about the danger of contact with dead birds. When outbreaks occur, governments should immediately offer realistic compensation to farmers for birds lost to disease and culling. Without this, poor farmers will be tempted to hide bird-flu outbreaks and continue to sell poultry that should be culled. Farming practices that mix poultry species in farms or live animal markets are a danger too, and must be addressed—although that might take longer. The effort would be helped if those in the poultry industry and governments in poultry-exporting nations would stop simply pointing to the risks posed by wild birds and start paying more attention to the movement of animals, products and people from infected to un-infected regions and countries.

Unusually for a complex problem with international ramifications, money is available to make a serious attempt at tackling it—$1.9 billion was pledged by the world's wealthier nations last month in Beijing. There is no excuse for delay, unless we want more dead people to follow lots more dead ducks.

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Free speech

Denying the holocaust

Feb 23rd 2006
From The Economist print edition

It is loathsome, but should not be a crime

AFP

FABRICATING history is an act of intellectual vandalism that poisons modern understanding of past misdeeds and heroism alike. But should it be a crime? In civilised countries, the truth is best policed by scholars, not criminal prosecutors. Historians who distort, inflate and invent find their credibility shredded by their peers, not the police. But David Irving, an author of books about the second world war, is now starting a three-year prison sentence in Austria (see article) for remarks he made in 1989 doubting the existence of gas chambers at Auschwitz. That has won him praise in Iran, where the president, Mahmoud Ahmadinejad, recently described the holocaust as a "myth".

Holocaust denial is ridiculous, but it is too common, and too damaging, to be a joke. It commonly makes four claims: that the numbers of Jews killed were wildly inflated; that any persecution was matched or exceeded by allied war crimes against Germans; that Hitler was ignorant of, or even opposed to, the killing of Jews; and that accounts of systematic extermination were invented to benefit Israel.

Holocaust deniers such as Mr Irving are expert at taking anomalies and contradictions in the historical record and erecting such pyramids of loathsome nonsense upon them. From the gaps (all explicable) in the surviving evidence about Auschwitz-Birkenau they infer that the gas chambers there were a propaganda invention. And not only that: other details of the Holocaust are invented too. In fact it didn't really happen: Hitler liked Jews. Or (as the Palestinian movement Hamas argues) Jews caused the war. Holocaust denial (or "revisionism" as its pseudo-scholarly advocates term it) uses quibbles, semantics and phoney logic to befuddle the gullible about the mass murder of millions of innocents.

To the fair-minded, such claims are preposterous. But among the prejudiced, silly and ignorant they flourish, especially on the internet. They gain a touch of intellectual legitimacy from a handful of cranky academics—though of these only Mr Irving has any claim to be a historian. His early works, particularly on military matters, were acclaimed. Nobody doubts his knowledge of German archives, or his skill in deciphering the crabbed handwriting of senior Nazis.

But there are plenty of doubts about his integrity. At a libel action in London in 2000, in which he had every chance to make his best case, the judge concluded that he was "anti-Semitic and racist", saying he had "persistently and deliberately misrepresented and manipulated historical evidence" and "portrayed Hitler in an unwarrantedly favourable light."

It is hard to see what the Austrian court's sentence can add to that. Keeping Mr Irving in jail at most may stop him going to a conference that Mr Ahmadinejad is convening to "rewrite and revise" the history of the holocaust. But against that small plus are two big minuses. One is that the sentence makes Mr Irving look a martyr. The other is that it makes the West look hypocritical: all too willing to bruise Muslim feelings, while protecting Jewish ones by law.

Laws against holocaust denial (which 14 countries have) were never a good idea. The best defence against neo-Nazis is reason and ridicule, not the criminal law. But at a time when the western world is battling to defend free speech against religious zealotry, they look particularly indefensible. It is punishment enough for Mr Irving that he has lost his professional credibility. He should not lose his liberty too.

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Economist.com OPINION
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Darfur

Never say never again

Feb 23rd 2006
From The Economist print edition

Three years after western Sudan burst into flames, NATO should provide an extinguisher

Get article background

ANYONE following events in western Sudan over the past three years, even casually, must be depressed about the world. In that span, many of Darfur's 6m inhabitants have been raped and massacred by militias armed by their own government. Some 300,000 people have died in the conflict; over 2m have been herded into camps. America described this as genocide well over a year ago. Yet it continues, fiercer than ever. As the violence crosses Darfur's western border, there is risk of war between Sudan and Chad, to which a good 200,000 Darfuris have fled. The world's response—7,000 peacekeepers from the African Union (AU), funded by the European Union—always looked inadequate. Naive, ill-equipped, underfunded, outgunned, they now look an embarrassment. Darfur needs fixing. So do the international mechanisms supposed to prevent such horrors.

Getting serious, at last

On both fronts, there is at least hope. Last week, George Bush lent support to recent talk of the UN taking over the AU mission. He also said NATO should provide extra help. The first seems sure to happen. The AU, which has approached its duties in Sudan with uncharacteristic seriousness, concedes failure. Pending its formal plea for assistance, the UN Security Council has requested plans for a UN mission. Even members previously reluctant to intervene in Sudan, namely China, which buys its oil, and Russia, which sells it guns, are expected to approve them.

At the confluence of Arab and black Africa, Darfur has known low-level violence for centuries. Arab tribes raided black Africans for slaves; small wars erupted over water and grazing. The violence worsened in 2003, after Darfur's African tribes rebelled against the Arab government in Khartoum, and the government armed their local Arab enemies. Both sides drew inspiration from the settlement of another war, longer and bloodier, that set Sudan's southern tribes against the government for four decades. The southerners were eventually promised the right to secede, which Darfur's rebels want too. Fearing fragmentation, the Sudanese government of Omar Bashir, which is battling yet another insurgency in eastern Sudan, responded viciously. It has bombed and strafed villages from the air, then launched its *janjaweed* militias into the wreckage. Satellite photos of Darfur show landscapes devoid of people and livestock, dotted with ashen rings of burned-down huts. Tribal affiliations are in meltdown. Darfur's rebels have splintered; a proxy war is raging between Chad and Sudan, each country's government backing the other's rebels.

In such chaos, the AU was bound to fail. Its mandate was not to enforce security in Darfur but to monitor a ceasefire, which both sides have ignored. More capable nations saw several reasons not to get involved. Given Sudan's history of Islamist militancy, from the Mahdi to Osama bin Laden, a guest in the early 1990s, there were fears that non-African UN troops would be resisted. These should be discounted. Sudan's fundamentalist government is loathed by most of its people.

Another worry is that, if overpushed, the government will restart the war in the south. The opposite is true. Without external pressure, especially from America, the government would not have made that peace; without still more pressure, it will inevitably break it. As for Sudan's sovereignty, a related concern, that is now forfeit. At a UN summit in September, every member, including Sudan, signed an agreement recognising a so-called “responsibility to protect”, allowing intervention in cases where “national authorities [are] manifestly failing to protect their populations from genocide, war crimes, ethnic cleansing and crimes against humanity.” That is precisely the case in Sudan, except for the twist that its government is not just failing to protect its people but also conniving in their persecution.

There is, however, another reason why the UN has not intervened in Darfur. It lacks the means. A record of incompetence deters capable western powers from lending it peacekeeping troops. Of more than 60,000 UN peacekeepers currently deployed around the world, only a few hundred are from the world's best armies.

Which is why the rescue of Darfur cannot be a job for the UN alone. Putting together a UN force would in any case

take many months. In the meantime, without serious troops on hand to stop it, the killing will continue. Someone needs to secure Darfur's border. Someone must force the Sudanese government's helicopters to stay on the ground. Someone must deter the *janjaweed* from continuing their attacks. At present, only NATO forces are capable of achieving this. The Security Council should give NATO its blessing. And NATO members should take a deep breath, and send in their troops.

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The war on terror

Why it will take so long to win

Feb 23rd 2006
From The Economist print edition

A speech by Donald Rumsfeld shows that the administration still doesn't get it

Reuters

IN A century's time historians may well ponder why it took America so long to win the war on terror, especially given that the world's foremost democracy was battling against opponents who would rather have dragged society back to the Dark Ages. If so, they may well find part of the answer in a speech Donald Rumsfeld gave last week on the role of the media at the Council on Foreign Relations in New York.

In one way, the speech marked a step forward for the defence secretary, because it concentrated on the need to win “hearts and minds”. Until recently he plainly regarded such a focus on “soft power” as, well, soft—part of “Old Europe's” appeasement of terrorism. No matter that his generals, allies and counter-insurgency manuals told him that it was impossible to defeat fanaticism without changing public opinion; the master of military transformation would “drain the swamp” in Iraq (and the wider Muslim world) through superior firepower, high-tech intelligence and incarceration. When people—even trenchant supporters of America, like this newspaper—harped on about such details as due process, the Geneva Conventions or the importance of explaining his policies personally to critics, it was proof of our weak-mindedness.

Now something—was it, one wonders, Abu Ghraib? Or Guantánamo? Or the torture memos? Or the fact that China now lectures America on human rights? Or the tragic decline in sympathy for America around the world?—seems to have prompted a meagre mental adjustment on Mr Rumsfeld's part. His recent Quadrennial Defence Review confessed that “victory in the long war depends on strategic communication” and even issued a plea for “considerably improved language and cultural awareness”. His speech in New York was an attempt to flesh out this strategy. Yet it ended up illustrating how completely the defence secretary still fails to “get it”.

Mr Rumsfeld's thesis was that al-Qaeda and other extremist groups had managed to poison the Muslim public's view of the West by somehow “out-communicating” America. A group of fanatics, whose leaders live in caves and dare not use cellular phones, has apparently been much better at mastering the modern internet age than the most sophisticated government in the world. A good part of his speech was focused on how with slicker PR America could win the propaganda war: there would be more media training for military personnel, 24-hour media operation centres, and so on.

In narrow terms, these prescriptions make sense. More controversial were Mr Rumsfeld's swipes at the media. He grumbled that the mockery of journalists had mucked up his crass scheme to pay for articles to be placed in Iraqi newspapers; that they jeopardised security (in a television interview, he claimed that al-Qaeda people had been tipped off by the disclosure that their phone calls could be listened to); and above all that his critics did not play fair, giving more space to America's transgressions (like Abu Ghraib) than to those of its enemies (such as Saddam Hussein's mass graves).

Some journalism is indeed indefensible: witness the disgustingly anti-American and especially anti-Semitic fare in many Arabic television stations and newspapers. And Mr Rumsfeld has every right to point out that the western

press makes mistakes—though some of them are at his bidding. He correctly attacked American TV networks for not showing pictures of Saddam's abuses. But they were also wrong to hide some pictures of American abuses at Abu Ghraib—which have now emerged on Australian television, sparking off fresh problems in the Muslim world.

The most unnerving thing about Mr Rumsfeld's remarks is that he still seems to think that winning hearts and minds is just a question of better presentation. But no amount of spin will make locking people up indefinitely without trial at Guantánamo Bay look compatible with American principles of justice. Mr Rumsfeld retorts that 15 detainees who had been released went back to the battlefield to try to kill Americans. A sad statistic, but a lot more than 15 hearts and minds are turned against America every day Guantánamo stays open. And exactly the same argument goes for the Bush administration's insane attempts to reserve the right to torture people.

These arguments have gone well past points of principle; they are to do with the hard pragmatic task of grinding out a victory against a relentless enemy. In its great struggle against Soviet communism—a far more potent foe than Islamist extremism—America stood firmly on the side of human rights and freedom. Unless it stands credibly on that side again, winning this fight will take far longer than it should do.

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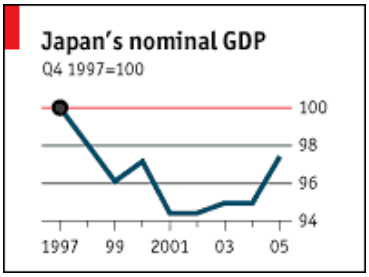
Japan's economy

Out, damned D word

Feb 23rd 2006
From The Economist print edition

The battle against deflation seems to have been won

Get article background



A LOT of nasty words begin with the letter D: disease, death, devastation and danger. In comparison, deflation might seem a relatively mild affliction. Yet Japan, the first economy to suffer prolonged deflation since the 1930s, has lived with its painful economic consequences. Falling prices mean that real interest rates cannot be negative when required to reflate a sick economy. Falling prices also inflate the real burden of debt. This, in turn, depresses spending, which further intensifies deflation. And so on, in a vicious spiral.

Central bankers have long known how to fight inflation, but have been flummoxed by deflation. Five years ago the Bank of Japan launched a monetary experiment—its so-called "quantitative easing" policy, which basically means printing lots of money. The economy seems to be responding: figures last week showed that Japan's real GDP grew by 4.2% in the year to the fourth quarter (and by a stunning 5.5% annual rate in the same quarter). On that measure, it is currently the fastest-growing rich-country economy (see article).

Before declaring deflation dead, however, policy-makers need to hack through a statistical tangle. According to the Bank of Japan's preferred measure, core consumer prices (which excludes fresh food) showed a year-on-year increase (albeit only 0.1%) in November and December: two small nails in deflation's coffin. But Japan's national accountants, who compiled last week's surprising growth figures, have a more dispiriting view of deflation. By their measure, prices appeared to fall by 1.6% in the year to the last quarter: the deflationary monster is still alive and well.

In fact, both measures are flawed and give a misleading picture of what is really happening in the economy. Japan's core rate overstates inflation, because unlike in other countries, it includes energy prices, which are surging. Equally, in an economy undergoing profound structural change and suffering from deflation, it is a particularly daunting task to know how much of a change in spending is due to a change in real output, as opposed to a change in prices.

This is why the only sensible measure of Japan's economic performance is nominal GDP, ie, total national output measured in money not volume terms. When inflation is high, only changes in real output offer any sensible guidance to how the economy is performing. But in a period of deflation, nominal changes matter much more: growing real GDP means little if the economy is contracting in money terms. Between 1997 and 2004 Japan's nominal GDP shrank by 5%, while America's spurted by 42%. The good news is that in the year to the fourth quarter of 2005 Japan's nominal GDP grew by 2.6%, its fastest annual growth for almost nine years. (Even so, nominal GDP still remains below its level in 1997.)

No nominal matter

Shrinking nominal GDP created a vicious circle by causing Japan's huge ratio of government-debt-to-GDP to rise further. Rising nominal GDP will now help to reduce that, and by boosting tax revenues it will slim the budget deficit. Faster nominal GDP growth also means that zero interest rates become more reflationary, since the gap between interest rates and nominal GDP growth is a good gauge of the tightness of monetary policy.

This underlines a big difference between today and August 2000 when the Bank of Japan briefly and prematurely abandoned its zero interest-rate policy. Real GDP growth was then running at an apparently healthy 2.5%, but nominal GDP was barely growing. Soon after the bank raised interest rates, deflation intensified and real GDP growth slowed sharply again. The Bank will be more cautious about raising rates this time, but sooner or later it will need to withdraw its unprecedented injection of liquidity if it is to prevent a future asset bubble. As Japan's economy becomes more normal, it is natural to expect a more conventional monetary policy. In economics, a bit more normalcy can be a jolly good thing.

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On free speech and the publication of cartoons

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Drawing no conclusions

SIR – Your leader on free speech viewed the attempts by Muslims to silence blasphemy against the Prophet Muhammad as an assault on the very essence of liberal society ("Cartoon wars", February 11th). Likewise, satirising Muhammad is seen by many Muslims as an assault on the very essence of Islamic society. Both sides display a worrying lack of pragmatism, but liberalism has remained the dominant ideology in the West precisely because it is pragmatic and able to respond to circumstances without clinging to sacred cows. The danger for liberalism now is that it hardens and becomes dogmatic. The Middle East does not really represent a threat to our freedom of expression; the situation is not akin to the medieval church or the Soviet Union, which were powerful and oppressive forces that hung over us. As we are in the position of strength, this was a moment when the liberal West should have shown its maturity and flexibility, rather than fearfully clinging to fundamentals.

Julian Evans
Moscow

SIR – I would agree that "free speech should override religious sensitivities" if the publication of cartoons deemed insulting by Muslims had taken place in the tolerant Denmark we knew ten years ago. Unfortunately, they weren't printed in that idealised country, but in a Denmark that over the past five to ten years has slid into an abyss of rampant xenophobia, nationalism, racism and, above all, a bottomless Islamophobia. The cartoons had nothing to do with freedom of speech, but with the conscious demonisation of a minority group.

Janne Teller
Paris

SIR – It is one thing to talk about defending free speech, but everyone, including Salman Rushdie, either recants or sticks their head in the sand when the bullets fly. Your lead editorial is a solid defence of cartoons I have still yet to see. Given the tone of the piece, I would have expected you to publish them to show solidarity with anyone brave enough to do the same. What happened?

Matthew Timms
New York

SIR – All those fine words about the pathetic response from some governments, about how "sensitivity cannot always ordain silence" coupled with a call to impose very few constraints on free speech. All convincing stuff. But when you get right down to it, talk, in this context, is cheap. You should have published some of the cartoons, whether you thought them offensive or not. You took the easy, safe way out and postured and displayed your fine moral credentials at next to no cost or risk to yourself.

James Allan
Garrick Professor of Law
University of Queensland
Brisbane, Australia

SIR – The freedom to "blaspheme" should be left to stand-up comedians and the like. It is not the job of serious publications to ridicule the religious sentiments held sacred by many. Freedom of expression without wisdom may well end up losing its purpose.

Rajiv Thind
Christchurch, New Zealand

SIR – The fact is that those newspapers which chose to publish satirical cartoons of the Prophet Muhammad crossed the line that separates civil society from barbarism. By all means let us have debates on religion, but let's

do so without insulting each others' beliefs.

Alistair Nicholas
Managing director
AC Capital Strategic Public Relations
Beijing

SIR – The present spat over those drawings seems to have less to do with fundamental rights than with common decency. I have the right to walk pretty much where I please, also “within the limits set by law”, but if I step on your toes I owe you an immediate apology—no ifs and buts. The republication of the drawings stomped on the toes of Muslims, again. Besides being rude, it was a tad silly, considering the consequences, don't you think?

Aage Westenholz
Copenhagen

SIR – It is right that politicians, including the Danish prime minister, do not apologise on behalf of newspapers. By doing so, they abrogate media freedoms and give themselves more power over the press, which is far more dangerous than furious demonstrations and burned embassies.

Odero Okoth
Nairobi

SIR – Governments did protect freedom of expression by not persecuting or prosecuting newspapers that published the cartoons. Beyond this, and contrary to what you imply, governments are under no obligation to provide vocal support or solidarity to actions taken by their media. Britain's foreign secretary, Jack Straw, has just as much freedom to call the cartoons unnecessary, insensitive, disrespectful and wrong as *The Economist* has to decry the response of western governments as inadequate and feeble.

Amrita Nain
Montreal

SIR – I sympathise with your distress at the American and British governments' lack of support for the Danes in exercising that most vital component of free speech—the right to caricature and satirise religious arrogance and pomposity. Mark Twain's view on similar behaviours in the past won't lighten our distress, but at least puts us in good company: “It is by the goodness of God that in our country we have those three unspeakably precious things: freedom of speech, freedom of conscience, and the prudence never to practise either”.

John Hasselberg
Minneapolis

SIR – Most of my fellow American Muslims who consider ourselves “moderate” have been in a bind. We regret the significance that Muslim communities around the world have attached to these cartoons, but we also feel slighted that the western media has turned their publication into a free-speech issue when the real issue is one of applying common standards in printing something so offensive. Muslims should ask themselves if the press would have published similar material that insulted blacks or Jews or other minorities in the name of free speech. This opportunistic posturing is why we feel slighted and betrayed by the West.

Samer Kurdi
Seattle

SIR – You needn't have apologised to Voltaire for your rewriting of the famous quote, “I disapprove of what you say, but I will defend to the death your right to say it”, as Voltaire never actually wrote those words. That distinction belongs to the not very distinguished biographer of Voltaire, S.G. Tallentyre (pen name of Miss Evelyn Beatrice Hall), who took responsibility for the unintentional confusion in a letter published in “Modern Language Notes” in November 1943. The provenance of the quotation may not be so rich as you assumed, but the clarion call it sounds is so well wrought it does not require the support of an illustrious name.

Alan Kennis
New York

SIR – The cartoon controversy brings to mind an aphorism by the American humourist Sam Levenson: “It's so simple to be wise. Just think of something stupid to say and then don't say it.”

Peter Ruchti
Marbella, Spain

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India and America

The great Indian hope trick

Feb 23rd 2006 | DELHI AND WASHINGTON, DC
From The Economist print edition

Not quite the long-awaited flowering of a beautiful friendship; at least, not yet

Reuters

“WE WHO are free—and who prize our freedom above all other gifts of God and nature—must know each other better; trust each other more; support each other.” Dwight Eisenhower uttered this pious hope in Delhi in 1959 and, ever since, an American president has popped back once in a while to utter it again. George Bush, who is expected at the beginning of March, will be the fifth to pay a state visit. Leaders of both the world's most powerful democracy and of its most populous one have long found it baffling and irksome that they are not firmer friends. Mr Bush has a better chance than any of his predecessors of putting that right.

Some reasons for optimism are long-standing, but seem to grow stronger over time. India is the second-most-populous nation on earth, and will eventually overtake China to take the top spot. Its booming economy has enhanced its commercial attraction, and the Confederation of Indian Industry's publicity campaign at this year's World Economic Forum in Davos has achieved the aim implicit in its slogan: “India everywhere”.

It is, moreover, a friendly democracy sitting between the two places American strategists worry about most: China and the Middle East. “We're natural allies,” says an American official, “We should have been closer much earlier.” The feeling, by and large, is reciprocated in India, if not among the chattering classes; Arundhati Roy, a novelist, argues that to seek an alliance with America “would be like inviting a brick to drop through your windshield”. But a poll of 15 countries last year by the Pew Research Centre found that 71% of Indians had a favourable view of America, the highest proportion of all.

Two other reasons to cuddle up to India have come into focus because of the preoccupations of Mr Bush's presidency. India has more Muslims (150m or so) than any country other than Indonesia, yet, as Mr Bush likes to point out, no known members of al-Qaeda. Second, India's growing economy has a desperate hunger for energy and, because of its reliance on dirty coal, risks becoming, in the words of Jacques Chirac, France's president, who was in India this week, “a chimney for greenhouse gases”. Helping India fuel itself more cleanly is a global imperative.

India's “non-alignment” in the cold war—when it tilted towards Moscow—combined with its pursuit of economic self-sufficiency and third-world solidarity, kept the two “natural allies” apart for decades. Two relatively recent developments, however, have boosted hopes for a close strategic partnership. First, India and Pakistan are two years into a formal peace process. This makes America's alliance with Pakistan less of a hindrance to its relations with India, though India continues to believe Pakistan sponsors “cross-border terrorism” in India, and America's friendship with it remains a bugbear.

The nuclear knot

Second, the Bush administration has shown itself willing to find ways round the biggest legal and political obstacle to full-fledged partnership: India's emergence in 1998, never having accepted the global non-proliferation regime, as a declared nuclear power. A “breakthrough” on this issue marked the visit by Manmohan Singh, India's prime minister, to Washington last July, and was to have provided the icing on the wedding cake when Mr Bush reciprocated the visit. It may yet do so. But it has also shown both the gulf between the two sides' perceptions of each other, and the political difficulty within both countries of whole-hearted strategic co-operation.

Last July, Mr Bush agreed to grant India “full civil nuclear-energy co-operation” and to help it acquire “the same benefits and advantages” as other states with nuclear weapons. This meant persuading Congress to amend laws blocking such co-operation, and prodding other countries in the Nuclear Suppliers Group to follow America's lead. The deal has provoked a considerable backlash from critics at home and abroad. India, meanwhile, had to do its bit. Most important, it had to draw up a plan for separating its military nuclear facilities from the civilian ones, and subject the latter to international scrutiny.

This has proved highly contentious. Many Indian strategists—and some leading members of the nuclear establishment itself—fear it is a way to force India to accept a cap on the size of its nuclear arsenal. If all India's power-generating reactors were put in the “civilian” box, then they would be barred from providing fuel to the weapons programme. This would inhibit its expansion should there be a sharp worsening in relations with its nuclear-armed neighbours, Pakistan and China. Others argue that India probably already has enough plutonium to build as many bombs as it is ever likely to need. International co-operation, argue proponents of the American deal, is essential if nuclear-power generation, which currently produces about 3% of India's electricity, is to make a bigger contribution to India's energy needs in the next two decades.

America did not find India's first separation blueprint “credible”. Nicholas Burns, an under-secretary of state, who has been negotiating with India, was expected back in Delhi this week to secure a more plausible one.

His efforts to reach agreement in Delhi and in Congress have been complicated because the debate has become entangled with another issue: Iran's nuclear programme. The Communist parties, on whose votes Mr Singh's Congress party-led coalition relies for a parliamentary majority, took great exception to India's voting at the International Atomic Energy Agency (IAEA) in favour of reporting Iran to the United Nations Security Council. The left's objections to the Iran vote are partly a matter of crude politics. Elections are due in the coming months in West Bengal and Kerala, two Indian states with large numbers of Muslim voters. But the left is also relying on the broader appeal of anti-American rhetoric.

Mr Singh has insisted that India voted in its own national interest. But in a news-agency interview last month, David Mulford, the American ambassador, pointed out that if India were to vote against the referral, it would mean the end of the India-America nuclear deal. This was no more than a statement of fact. America's Congress would surely not agree to rewrite the non-proliferation regime for one exceptional country, were that country, India, to line up on the opposing side in the most important nuclear-proliferation argument of the moment. Mr Mulford's remarks, however, were taken as a threat, and raised nationalist hackles.

Some former diplomats worry that India is paying too high a price for the new partnership. They point to a cabinet shuffle last month, when the petroleum portfolio was taken away from Mani Shankar Aiyar. Mr Aiyar had been aggressively pursuing India's “energy security”, which involved dealings with states America would prefer India to shun. Besides buying, in partnership with China, an oilfield in Syria, India has been discussing a pipeline to bring gas from Iran through some dangerous bits of Pakistan. Proponents of this project see it as an enormous boon to regional security, as well as to India's energy needs. America, however, opposes such a huge deal with Iran. Inevitably, there are suspicions that Mr Aiyar was a sacrifice on the altar of Indo-American partnership.

Misgivings about perceived American meddling run deep. M.J. Akbar, editor of the *Asian Age*, a newspaper, has noted that “The Indian street has been nourished by the view that America is a democracy at home and a dictatorship abroad...Indians do not make good stenographers. They simply do not like taking dictation.”

The China syndrome

Whatever the short-term outcome of the nuclear talks, they are unlikely to resolve the controversy in both countries. But nor will Mr Bush and Mr Singh abandon their pursuit of closer partnership. On the American side, one motive for this is usually couched in the most delicate diplomat-speak. The American government neither wishes to “contain” China, nor imagines that it can (though many congressmen would like to try). But America does have an interest in “preventing Asia from being dominated by any single power that has the capacity to crowd out others”, and that may threaten America's alliances in Asia. So Ashley Tellis, then a scholar at the Carnegie Endowment for International Peace (and now on secondment to the State Department), told Congress in November. Others put it more bluntly. “Of course we should sell advanced weaponry to India,” argues Robert Blackwill, Mr Mulford's acerbic predecessor as ambassador to India. “The million-man Indian army actually fights, unlike the post-modern militaries of many of our European allies.” America should help India with its space

programme without worrying too much whether that will help India build missiles. “Why should the United States want to check India's missile capability in ways that could lead to China's permanent nuclear dominance over democratic India?” he wrote last year in the *National Interest*, a foreign-affairs journal.

India certainly has no intention of joining an anti-China axis. Nor, for now, does it have to choose between two big suitors. China, which at first voiced reservations about the Indian nuclear deal with America, is now shrewdly acquiescent. Perhaps it hopes that American congressmen and Indian Communists will kill it anyway. Or perhaps it does not want to jeopardise its own fast-improving relations with India.

American businesses are not as excited by India as they are by China, for the obvious reasons that China's economy is two-and-a-half times bigger, is growing faster and is more integrated with the rest of the world. In each of the past four years, the annual increase in China's foreign trade has exceeded India's total merchandise trade. Last year China received about ten times as much foreign direct investment as India did.

Yet American business is well aware of India, in large measure thanks to India's expertise in software development and other sorts of “outsourced” services. Despite the protectionist hoo-hah ahead of the American presidential election in 2004, outsourcing to India has not slowed at all. More than half the *Fortune* 500 companies outsource some of their information-technology work to India, and the rest have to explain to shareholders why they are not doing so.

This is not simply a matter of cost arbitrage. Azim Premji, chairman of Wipro, one of India's big information-technology firms, says that in India the very best young talent is moving into the profession—membership of which is even good for marriage prospects. America, by contrast, is not producing software engineers in the numbers it needs.

According to Promod Haque of Norwest Venture, a venture-capital firm, it is also suffering a “reverse brain-drain” as Indian and Chinese engineers go home. This, he argues, coupled with the retirement of the baby-boomers, is creating a “shortage of intellectual capital” in America which will eventually threaten its superpower status. The solution is to build a “strategic competitive advantage” through an alliance with an offshore base of intellectual capital. India is the obvious choice. Its pool of highly qualified graduates will be twice as large as China's by 2008, according to the McKinsey Global Institute, and they speak English.

Such a de facto alliance is already in the making, and is helping alert American business to India's other attractions: an economy expected to grow by more than 7% in 2006, for the fourth year running; a fast-expanding middle-class; and a government committed to liberalisation, even if implementing it is painfully slow. In the past year, India has allowed foreign firms to enter the construction and property industries, signed an “open skies” agreement with America and passed a patent law that meets WTO standards. As India continues to open up new industries to foreign investment, the opportunities for American firms are proliferating, says Ron Somers, head of the US-India Business Council. Two-way trade last year was only some $20 billion, but the nuclear deal itself may offer a bonanza for American suppliers of equipment. India is also by some estimates the world's biggest arms importer.

Reuters

American businesses have their gripes about India. They would like it to simplify its spaghetti-spill of bureaucracy, open up its markets faster and fix its rotten infrastructure. American insurers would like to be allowed to buy more than 26% of one of their Indian counterparts, for example. “Single-brand” retailers (eg, shops selling only Nike goods) are glad to have been allowed this year to open stores in India; general retailers such as Wal-Mart would like to be allowed in next.

None of these moans, however, approaches the intensity of the Japan-bashing of the 1980s or the China-bashing of today. India is seen as less of a threat, being neither rich, like Japan, nor an aggressive autocracy as China is. American union bosses complain far less about India than they do about China.

The promised land

India loves being in the international spotlight. Hotels are full, airports packed and the foreign ministry deluged with foreign dignitaries. Recent figures, which show the economy growing at more than 8% a year, have propelled the stockmarket into uncharted territory, with its main index up by 50% in a year. There is an air of euphoric expectation that at last India is reclaiming its rightful place both in the world economy and in the global balance of power.

Reuters

The IT country

Retailing, new Indian style

Not everyone is basking in this glow. Andy Xie of Morgan Stanley, an investment bank, frets that “India is experiencing typical overheating symptoms of an emerging-market boom: widening current-account deficit, high and accelerating inflation rate, and rampant stock-and property-market speculation. India's macro environment is quite similar to Latin America in 1980s and South-East Asia in 1990s.” India's low external indebtedness, managed exchange rate and large foreign-exchange reserves should insulate it from a financial-market shock. But Mr Xie is not alone in worrying about the dependence on inflows of portfolio investment to finance a current-account deficit.

Besides those giving warning of the short-term risk of a financial crisis, some observers also cast doubt on the staying-power of the present spurt of growth. In a new book, Shankar Acharya, a former chief economic adviser to the government, argues that over the next five years economic growth is more likely to average 5.5-6% a year than the 8-10% optimists now see as India's birthright.

That is still, by most standards, a boom. But the distribution of growth also risks sharpening regional and social differences. For Ms Roy, India is a land where gangs of emaciated labourers dig trenches to lay fibre-optic cables by candlelight. India's “progress” of the past decade and a half, she reckons, is like two convoys of trucks: a tiny one “on its way to a glittering destination somewhere near the top of the world” and a huge one that “just melts into the darkness and disappears.”

Of course, when celebrated novelists worry that a country is melting into the darkness, its prospects are probably bright. But Ms Roy touches on a concern shared by many economists: that, for all its phenomenal success in IT and some high-end manufacturing industries, India's boom has yet to reach many of the two-thirds of its people who live in the countryside. A particular concern is the failure of labour-intensive manufacturing to take off. According to a recent IMF paper, the proportion of the workforce employed in manufacturing actually fell slightly in the 1990s.

Stability, democracy, demography

Nevertheless, in the long term, India has two great attractions. One is stability. India has proven mechanisms for the peaceful transfer of power and the ability to withstand terrible internal conflicts—in Kashmir and the north-east, for example—without danger to its integrity. China's eventual transition to democracy could be traumatic. Another attraction is demography. China's one-child policy ensures that it will grow old before it gets rich: a generation of only children may suddenly find themselves struggling to support the parents who once pampered them. India will remain younger and more dynamic well into the middle of the 21st century.

For many reasons, a close partnership between India and America seems both desirable and inevitable. The fraught negotiation over the nuclear issue, however, has revealed how difficult it will be to achieve. To America, and to many Indians, it must seem inconceivable that India—still so poor, and so desperately in need of just the sort of help America is offering—should not jump at the chance of a special relationship. How on earth, for example, could the idea of siding with Iran instead be seriously debated? But for many in India, “non-alignment” is a synonym for independence, and should not be sacrificed, however enticing the prize. Moreover, so confident is India's mood at the moment, that many seriously believe America needs it more than the other way round. Tomorrow belongs to Asia.

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America's ports and Dubai

Trouble on the waterfront

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Getty Images

America's ports have not caused so much excitement since the Boston tea party

XENOPHOBIA seems to be creeping into American politics. Last year, Congress saw off the yellow peril from China, whose CNOOC oil company dared to bid for America's Unocal (though most of Unocal's oil and gas reserves happened to be outside America). Now it is the Arabs—for which read terrorists—who are threatening to imperil America's national security by taking over some of its ports.

On February 13th, DP World, a ports operator owned by the government of Dubai, a small but economically ambitious member of the United Arab Emirates, paid $6.8 billion to acquire P&O, a British firm which runs a global network of maritime terminals. With P&O came six American ports—Miami, Philadelphia, Baltimore, New Orleans, New Jersey and New York.

Ever since the contract was signed there has been a noisy response from American politicians. Robert Ehrlich, the Republican governor of Maryland, and Jon Corzine, his Democratic peer in New Jersey, both want to stop the deal. The two most vocal protesters are Chuck Schumer, a Democratic senator for New York (and famed China-basher), and Pete King, the Republican chairman of the House Homeland Security Committee (and friend of Gerry Adams, the leader of Sinn Fein). They say they will shortly propose emergency legislation to block the deal before completion, which is due on March 2nd.

Presidential hopefuls have also rushed to sound the alarm. Hillary Clinton, New York's other senator, will introduce legislation prohibiting the sale of port operations to foreign governments. On the Republican side, George Pataki, New York's ambitious governor (who is retiring), is considering cancelling the lease which the New York-New Jersey Port Authority has granted to the port operators. And the Senate majority leader, Bill Frist, has asked the president to take a second look.

To his credit, George Bush has risen above such populism, reasserting his free-trade principles by promising to veto any legislation that tries to block the takeover. Mr Bush's problem is that, with the exception of Jimmy Carter and John McCain, no prominent politician seems inclined to speak out on his side. With mid-term elections looming in November, Congress may well find enough votes to override the presidential veto.

As with CNOOC, politicians are claiming that this is less about protectionism than about the purchase of American assets by firms that are, in effect, arms of a foreign government. Continental Stevedoring & Terminals, one of P&O's partners, has filed a lawsuit in Miami claiming that under the sale it will become an “involuntary partner” with Dubai's government. The dockworkers' union says it is ownership by a foreign government that scares its members most. Yet Dubai is much more obviously a friend of America than is China. And, anyway, is this really what this dispute is about?

The most persistent complaint, heard also from families of victims of the September 11th attacks (some of the terrorists had links to the United Arab Emirates), is that it will imperil America's national security. Critics protest that the deal has not been adequately vetted. The Committee on Foreign Investment in the United States (CFIUS), which includes representatives from the Departments of Defence, State, Treasury, Commerce and, most important, Homeland Security, approved the takeover in the minimum 30-day period. Critics say it must have been superficial, and they are furious that the deliberations behind the decision are classified.

Inevitably, too, there is a business connection to the Bush administration. The sort of people who claim that the White House is a subsidiary of Enron and/or Halliburton have spotted a link between DP World and John Snow, the treasury secretary, whose agency heads the federal panel that signed off on the sales. Mr Snow used to run CSX, a railroad company that, after he had left, sold its port operations to the Dubai firm for $1.15 billion in 2004.

Underneath all the posturing is one legitimate worry: ports are one of America's weak spots when it comes to national security. Only 5% of the containers that bring 2 billion tonnes of freight to the ports each year are inspected on arrival. That is up from 2% before September 11th 2001, but is still worryingly low. Weapons of mass destruction could be smuggled in and, if the ports themselves were targets, closures or even interruptions would disrupt the global supply chain, says William Daly of Control Risks, a consultancy. This would mean potentially huge consequences for the American and world economies.

But will letting DP World operate there really make a material difference to that risk? Nobody denies that Dubai, though pro-western, is a notoriously porous place, with blind eyes reputedly turned to shipments of drugs and arms. A.Q. Khan's Pakistani nuclear-smuggling network, for instance, was hidden behind a Dubai front. But that does not mean DP World is unfit. It is a globally respected firm with an American chief operating officer, Ted Bilkey, and an American-educated chairman. When Mr Bush nominated an American manager from DP World to a ports post in the Department of Transport last month, nobody objected (though they are complaining now). The company will not own the American ports and it has no incentive to run them badly. Just as under P&O, American coast guards, customs and immigration people will remain fully responsible for security.

The United Arab Emirates is a member of America's Container Security Initiative, which allows American customs officials to inspect cargo in foreign ports before it leaves for America. The employees will continue to be unionised (and presumably patriotic) American citizens. Any Arab employees whom DP World ships in will be subject to American visa approval, no easy matter nowadays.

Alas, America's politicians seem to be in no mood to discuss this issue rationally. So much easier, and more popular, to base policy on the prejudice that every Arab is a potential terrorist.

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Of mansions and residences

The house that Jack built

Feb 23rd 2006 | BOISE
From The Economist print edition

AP

A pretty nice place to entertain

But will Idaho's governor live there?

EVEN from well across Boise, the J.R. “Jack” Simplot mansion is impossible to miss. Not only does it sit on a sizeable hill, with a massive American flag whipping round a 150-foot flagpole. In summer, it stands out as the only green patch in its high-desert surroundings. The sloping lawns are irrigated by 2,200 sprinkler heads. It is a popular place for “ice-blocking”—Idahoans' summer sport of sliding down steep hills on large chunks of ice.

Last year Mr Simplot, a nonagenarian billionaire, donated his 7,370-square-foot house and 37 acres of land to the state of Idaho. The only stipulation was that the flag should keep flying. But it was clearly intended to house the governor. The current one, Dick Kempthorne, lives in a condo in east Boise and might like a bigger place to entertain.

Politics is now getting in the way. Maintenance costs for the house will be hefty, but a bigger row has erupted about expanding the property. To boost security (while deterring development), the governor has proposed putting aside $2m in public money to buy more of the surrounding land if it comes up for sale. The legislature will decide soon whether to keep the appropriation.

Mr Kempthorne will never live in the new place, since he will be retiring this year. And candidates for his job, though they like Mr Simplot's generosity, reject his house. “I think it is regal, undemocratic, inappropriate and altogether wrong,” thunders Jerry Brady, a Democrat. Dan Adamson, a Republican candidate with a better chance of being elected, says he might share the place with an industrial museum, or allow the PTA to run a bed-and-breakfast. No word from the Republican front-runner, C.L. “Butch” Otter, who was once married to a Simplot daughter.

If Idaho ends up staying mansionless, it will not be alone. California, Vermont, Rhode Island, Massachusetts and Arizona also lack official homes for the governor. Idaho's situation seems oddly like California's in the 1970s. Back then, Governor Ronald Reagan ordered a 12,000-square-foot mansion on a riverside bluff near Sacramento. Jerry Brown, the next governor, called it the “Taj Mahal” and refused to live there. The empty mansion, which Joan Didion compared to “the lobby area in a Ramada Inn”, was sold in 1982. When Arnold Schwarzenegger is in Sacramento, he stays in a hotel.

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The states

Living on borrowed time

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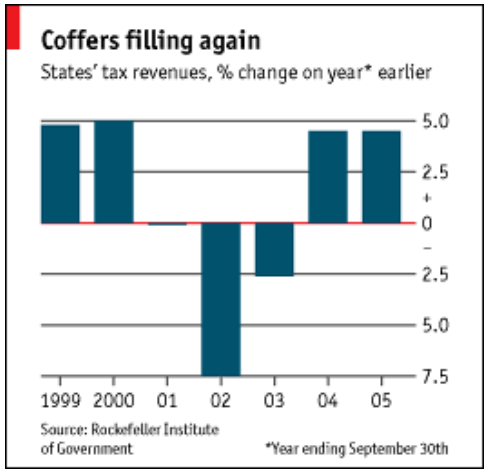
Money is flowing back into state coffers. But how long will the good times roll?

THERE may be two Americas, but when the country's governors kick off their annual gathering on February 25th, in Washington, DC, the crucial divide between them will not be between Democrats and Republicans. State executives are too pragmatic for that. Instead, the political gulf to watch is the one between now and later. The 27 governors who are running for re-election this November care far more than the others about short-term success. So they have reason for cheer.



Over the past two years state tax revenues have come roaring back across the country, after dropping sharply from a recession in 2001. That gives incumbents, from California to Connecticut, lots of ways to spread fiscal goodies around while still saving enough to look responsible. But the other half of America's governors—those who will be running their states for at least a couple more years, or are considering their legacies ahead of November retirements—are looking towards the horizon, where budget problems are looming.

Both sales-tax and personal-income-tax revenues fell after the last recession; now the money is pouring in again, with states also helped by rising asset prices. The Rockefeller Institute of Government, at the State University of New York, strips out the effects of new tax laws to gauge how much the economy is helping or hurting states' tax receipts. By its measure, real tax revenues fell by 10% in the two years after the September 2001 terrorist attacks, but have grown by 4.5% in each of the past two years. With a few regional variations (the Gulf states are still reeling from Katrina), that trend should continue this year.

For incumbent governors, this could not be better timed. Brian Stenson at the Rockefeller Institute points out that in four big elections this year—in Arizona, California, Connecticut and Maryland—the incumbents are all cutting taxes, spending more on schools and making a show of replenishing budget reserves. In Connecticut, which expects a $510m surplus this year, Jodi Rell has called for $295m in tax cuts in her next budget, including slashing gas and electricity taxes by a quarter. Her fellow Republican, Robert Ehrlich of Maryland, wants to cut taxes on estates, marital trusts and military pensioners, while boosting education spending by 11.5%.

Democrats are playing the same game. In Arizona, Janet Napolitano's new budget calls for a 20% increase in general spending and a raft of small tax breaks. In Illinois, Rod Blagojevich boasts that he has doled out plenty of extras (including free health care for kids) without having to raise taxes. He has pulled off this stunt partly through what Therese McGuire, of Northwestern University's business school, calls a series of “Band-Aids or one-shot deals”: counting future pension savings as current revenues, raiding the highway fund and inhaling the state's tobacco-settlement money, all in one go. But rising incomes and tax revenues have also helped Mr Blagojevich, who is now dreaming of offering universal free kindergarten.

What will happen when the music stops? Unlike the federal government, America's states do not have the luxury of running up deficits, so they typically set aside money for a rainy day. The National Association of State Budget Officers expects the current year's spending spree to whittle those reserves down from 6.9% of annual expenditures to 4.6%—less than half the level before the recession.

The states may need those reserves badly. Health-care costs continue to rise, with state Medicaid programmes especially under threat. Many other governors have been playing the same sorts of pension-fund games as Mr Blagojevich. And, sooner or later Congress will have to rein in the federal budget deficit. The states could face a drop in federal funds even as they are handed more duties of care for their own citizens. The incumbents are putting off these sobering thoughts until next year; America's other 23 governors should confront them sooner.

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A defenestration at Harvard

The Summers also sets

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The ousting of Larry Summers had more to do with the balance of power on campus than ideology

AP

No sufferer of fools

HARVARD likes to think of itself as the best university in the world. People who didn't go there may beg to differ, but this week Harvard proved that it is undoubtedly a world-beater in one discipline: academic back-stabbing.

On February 21st Harvard's president, Larry Summers, announced that he is stepping down after just five years in his job, making him the shortest-serving president since Cornelius Felton, who died after two years in office in 1862. Derek Bok, who ran the university in 1971-91, will serve as interim president until a replacement can be found. Mr Summers's abrupt retirement not only raises questions about Harvard's commitment to free speech, given the long-standing *jihad* against him; it also throws the university's ambitious reform programme into disarray.

Mr Summers's departure was precipitated by another resignation—that of William Kirby, the dean of the powerful Faculty of Arts and Sciences (FAS). Mr Summers edged Mr Kirby out because he thought that he had allowed the reform of the curriculum to get bogged down. But the departure was handled badly even by Mr Summers's abrupt standards (the dean apparently learned about his resignation from the press). And the resulting furore gave Mr Summers's critics a chance to table a vote of no confidence.

The vote, set for February 28th, was particularly perilous for Mr Summers because the FAS had already passed a vote of no confidence in him in March 2005. This didn't destroy him last year because the powerful Harvard Corporation—the university's six-member board—chose to back him. But this time things were different. Opposition to Mr Summers had strengthened and the Corporation was losing confidence in its president's ability to run the university. Mr Summers jumped before he was pushed.

This was all rather unfair. None of the other faculties has ever joined FAS in expressing no confidence in Mr Summers. A poll in the *Harvard Crimson* revealed that undergraduates were opposed to Mr Summers's ousting by a majority of three to one. Alan Dershowitz, a law professor, dubbed the situation as “an academic *coup d'état*” by the “hard left”.

Mr Summers arrived in 2001 with a mandate for change. The Corporation recognised that Harvard could keep its edge over up-and-comers like Stanford only by remaining nimble. And they were impressed by Mr Summers's clear vision of reform. He wanted to refocus undergraduate education, improve science teaching, build a whole new campus across the river and make Harvard a global university. The Corporation bet that the former treasury secretary had the right qualifications for the job: he had taught economics at Harvard before going into government, and his bulldozer-like personality would bully the reforms through.

Ever since then the bulldozer has been hitting walls. He clashed with Cornel West, a well known black professor, over Mr West's commitment to academic research. He challenged the banning of the army training corps from the

Harvard campus. He suggested that a petition urging the university to sell stakes in companies doing business in Israel might be “anti-Semitic”. He went out of his way to defend his friend Andrei Shleifer from accusations that the economist had violated conflict of interest rules by investing in Russia. (Harvard and Mr Shleifer paid almost $30m to settle a civil suit brought by the American government over the issue.) And, most famously of all, Mr Summers infuriated the feminist establishment (and many others) by wondering out loud whether prejudice alone could explain the shortage of women at the top of science.

It is tempting to present Mr Summers as a neo-conservative fallen among liberals. In fact, ideologically he is something of an old-time liberal himself (he devoted a great deal of energy to boosting the number of poor students at Harvard). His problem has always been that his affection for any agenda is less than his love of a good debate. Political correctness depends on self-censorship, especially over group differences, and Mr Summers is constitutionally incapable of not examining people's premises.

In the end, though, character was less important than power. There was a set of much more basic tensions between Mr Summers and his critics. These tensions might be dressed up as ideological, but they were really about the privileges and perks of academic life.

The most obvious was undergraduate teaching. Undergraduates get a raw deal for their $40,000 a year. The core curriculum is an antiquated mess. Star professors palm their pupils off on graduate students and then give them top grades to keep them happy (one survey found that 91% of Harvard graduates get honours compared with just 51% at Yale). Mr Summers tried to use the bully pulpit to force professors to teach more seriously; hence his attack on Mr West.

The second was a tension between science and the humanities, or between hard and soft subjects. Mr Summers made no secret of his personal enthusiasm for the hard sciences; he was scathing about squishy “ologies”. Some Harvard types speculated bitterly that he wanted to turn Harvard into an Ivy-clad version of the nearby Massachusetts Institute of Technology, the university that accepted the young Larry when Harvard turned him down.

Above all, there were the tensions that flowed from his desire to strengthen a famously weak presidency. He tried to ensure that more money was funnelled through the president's office. (In 2002 the central administration controlled much less than the dean of the FAS.) He directed money to graduate schools he approved of, installed sympathetic deans and tried to shape the professoriat by choosing scholars whom he admired. The FAS fought back.

Nice job, if you have no opinions

This is not to say that Mr Summers didn't create unnecessary difficulties. He didn't suffer fools gladly (and fools with PhDs are particularly sensitive to charges of stupidity). He measured all academic life by the standards of economics and mathematics. He infuriated Harvard by bringing an entourage of Washington flunkies and by being ferried around in an official car. And he annoyed his allies by giving in: were his comments about women really so terrible that he had to pledge $50m to promote women in science?

Yet there was more to the Summers wars than the main protagonist. His defeat prompts a bigger question: is the modern university governable? With 20,000 students and annual expenses of about $2.8 billion, Harvard is huge. Its senior employees have lifetime tenure and there are plenty of other tough constituencies, from pushy alumni to students who are paying through the nose to be there.

The job of a university president is shrinking from being a public intellectual to being a mere fund-raiser, and a temporary one at that. During the 20th century the average tenure of Harvard presidents was 20 years. But Mr Summers's predecessor, Neil Rudenstine, lasted only for a decade, and had a very public nervous breakdown in the middle of his reign. Mr Summers was gone in half that time.

Harvard will probably have no shortage of applications for the job of running the world's richest university (its endowment is now $26 billion). But it is hard to imagine a reformer wanting the job, particularly now that the FAS has tasted blood and the Corporation has given in.

Harvard has tended to go through bouts of reform followed by periods of consolidation. The most important bout of reform came with James Conant (1933-53), who took a Brahmin university—regional, parochial, snobbish, resistant to Jews, women and new subjects—and turned it into a national, meritocratic university. Harvard now desperately needs to push through equally radical reforms: improving undergraduate education while also seizing the opportunities of science and globalisation; correcting many of the problems of the sixties, while also reaching out to poorer students. Even if he was the wrong messenger, Mr Summers definitely had the right message.

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The Global Nuclear Energy Partnership

Reactor dreams

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Not yet off the drawing board

“IF A problem cannot be solved,” suggested Dwight Eisenhower, “enlarge it.” When George Bush announced a new Global Nuclear Energy Partnership (GNEP), in a radio address on February 18th, he followed Ike's advice.

Mr Bush's problem is how to deal with proliferation risks while promoting nuclear power. His solution is to get countries that already have advanced nuclear industries to “lend” nuclear fuel to poorer countries that need it, then recover the spent fuel from them for recycling and burning down, getting rid of dangerous nuclear wastes. The borrowers would forgo costly uranium-enriching or plutonium extraction of their own (technologies that can be used for making reactor fuels, or abused to make bombs). This would make it harder to do the covert nuclear dabbling that may be going on in Iran.

The Department of Energy guesses that by 2050 energy demand will have doubled and there will be 1,000 nuclear power stations dotted about the globe (compared with fewer than 450 today). Without a big change in the way nuclear fuel-making is handled and nuclear waste is managed, the proliferation risks will grow too. Mr Bush hopes that new safer, smaller and simpler reactors can be built for developing countries; and that new technologies will extract more energy from fuels, while reducing both the amount and danger of left-over waste.

There is a logic to this. America stopped extracting plutonium from its spent fuel in the 1970s. But others continued, leaving 200 tonnes of civilian plutonium around the world, a big proliferation risk. If GNEP technologies—more proliferation-resistant recycling techniques and fast-burning reactors—can move from the lab to production, plutonium stockpiles could eventually be eliminated.

So far, claims an enthusiastic Clay Sell, the deputy secretary for energy, the idea has at least had a good hearing in London, Paris, Moscow, Beijing, Tokyo (all potential partners) and Vienna (home of the UN's International Atomic Energy Agency). But will they also chip in to the huge cost of making the technology work?

Mr Bush has included $250m in his next budget for R&D, with larger sums promised for what is likely to be at least a ten-year effort to produce a pilot fast-burner reactor. The danger, says Victor Gilinsky, an energy consultant and former member of the Nuclear Regulatory Commission, comes in basing energy policy on technologies that may never work and, if they do, will be exorbitantly costly. So much so, he argues, that the bits involving new technologies will need to be government-run: a form of “nuclear socialism” that will finance laboratories for years but never be commercially viable.

And even if more fuel is burnt more efficiently, there is still the problem of where the waste will go. Successive administrations have failed to build a repository for high-level (unrecycled) nuclear waste at Yucca Mountain in Nevada. Mr Sell points out that, on present levels of nuclear use, America will need nine more Yuccas this century. Unprocessed spent fuel takes 1m years to pass its peak of radioactivity; recycled fuel wastes take a mere 1,000 years.

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California and the death penalty

The needle and the damage done

Feb 23rd 2006 | LOS ANGELES
From The Economist print edition

Is lethal injection really so painless?

CALIFORNIA has recently endured two extended execution dramas—over whether to spare Stanley “Tookie” Williams, a repentant gang leader, and Clarence Ray Allen, a septuagenarian murderer. With Michael Morales, the question is not whether to execute him—California's governor Arnold Schwarzenegger has denied clemency—but how to do it. Because this question remains unresolved, the confessed murderer remains alive in San Quentin prison.

Mr Morales, who in 1981 strangled, bludgeoned, stabbed and raped his cousin's 17-year-old girlfriend, was due to die by lethal injection at one minute past midnight on February 22nd. However, the execution was halted in the nick of time when two anaesthesiologists belatedly refused to oversee the procedure. A second appointment in the death chamber, scheduled for 7.30pm on the same day, was postponed indefinitely when the prison authorities could find no medically qualified person to assist.

The need for medical personnel to be inside the chamber—rather than watching from outside merely to certify death—follows rulings by a federal district court judge, Jeremy Fogel, that could have implications far beyond California. Bearing in mind the constitution's ban on “cruel and unusual punishment”, Judge Fogel decided that California's three-stage procedure—a sedative of sodium thiopental, then a paralysing drug such as pancuronium bromide and finally a heart-stopping injection of potassium chloride—might hide rather than eliminate a prisoner's pain. Hence the instruction that doctors should be present.

That two anaesthesiologists could be found in the first place raised eyebrows in the medical community. But the two who accepted the job ducked out, saying that the possibility of having to intervene were Mr Morales to wake up or be in pain “would clearly be medically unethical”.

Hence Judge Fogel's second ruling: the state could go ahead with the execution, with a licensed medical professional administering a single, lethally large dose of the sedative. Since the state could not find a qualified person in time, Mr Morales returned to his cell. The warrant for his execution has now expired, and because the judge who originally sentenced him now thinks he should be spared, the stay of execution could be permanent.

In the meantime, Judge Fogel has said that he will hold a hearing on the injection procedure in May. Since lethal injection is used in 37 of the 38 states that practise capital punishment, that could make for some far-reaching testimony. Stories abound of prisoners taking time to die, of suffering convulsions and of being in pain; indeed Judge Fogel referred to Williams's drawn-out execution as San Quentin in December. In the past two weeks courts in Florida, Missouri and Maryland have all issued stays of execution in cases challenging injection as a procedure.

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Law and order in Hollywood

One for you, Philip Marlowe

Feb 23rd 2006 | LOS ANGELES
From The Economist print edition

An everyday story of wiretapping, explosives and dental floss

AP

Pellicano pleads innocent

IT COULD be the plot of a TV mini-series. A top entertainment lawyer is indicted on wiretapping and conspiracy charges; a movie star is named as a witness; the press carries bitter tales of an ageing billionaire's divorce from a young tennis pro; a private investigator is accused of racketeering and wire fraud for illegally gaining access to the driving and police records of dozens of individuals. Meanwhile, Hollywood's elite nervously wonder who will be named next.

The lawyer is Terry Christensen, indicted by a grand jury last week for allegedly paying the private investigator, Anthony Pellicano, over $100,000 to tap the phone of Lisa Bonder Kerkorian. She is a former tennis pro who in 2002 was demanding $320,000 a month in child support from Kirk Kerkorian, an octogenarian billionaire. A judge subsequently set the amount at $50,316 a month—but only after plenty of unsavoury details had emerged, not least the accusation from another Hollywood type, Steve Bing, that Mr Kerkorian had stolen his dental floss to find DNA evidence that he was the father of Mrs Kerkorian's child.

Several actors are named as victims of wiretapping, sometimes on behalf of angry wives. The best-known is Sylvester Stallone, allegedly the victim of wire-tapping organised by Mr Pellicano during the actor's dispute with a former business manager. In fact, Mr Stallone appears twice in the indictment, by name and under the pseudonym he apparently uses on his travels, “Johnny Friendly”, the name of the union boss in “On the Waterfront”.

Mr Christensen and Mr Pellicano both insist they are innocent. Last week's indictment came just as Mr Pellicano was completing a 30-month prison sentence after police found explosives and hand grenades in his office. The cops' interest had been sparked by threats to a journalist investigating Steven Seagal, another action-movie star.

The case is due to come to court in early April. The indictment identifies more than 60 people whose phones were allegedly tapped by Mr Pellicano or his accomplices. It is not always clear who was hiring Mr Pellicano; many of his clients may claim they knew nothing about his methods. Meanwhile, the creator of “Law & Order” is planning another series, to be called “Power”. Apparently it will feature young federal agents and lawyers investigating Hollywood power-brokers—and their involvement in wiretapping.

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Lexington

Puritans or pornographers?

Feb 23rd 2006
From The Economist print edition

The schizophrenia at the heart of anti-Americanism

DURING George Bush's first term, public diplomacy might have been summed up in the phrase “Never apologise, never explain”. This time round Mr Bush is going for a more emollient approach. Condoleezza Rice is putting much more effort into diplomacy of all varieties, public and private, than Colin Powell did (for one thing, she's less allergic to aeroplanes); the administration's two leading bovver-boys, Dick Cheney and Donald Rumsfeld, have shot themselves in the feet; and Mr Bush has signalled his commitment to improving America's image abroad by putting his trusted confidante, Karen Hughes, in charge of America's public diplomacy.

But will this renewed emphasis on soft power make any difference? There are lots of reasons for scepticism. One is that huge power inevitably provokes huge suspicion. A second is that America's policy in Iraq has solidified that opposition into a global phenomenon. But consider a third, advanced by Peter Berger, one of America's best-known sociologists, at a Washington, DC, seminar (organised with James Hunter, the academic who invented the term “culture wars”). Foreigners, argues Mr Berger, have oddly confused views of America as a land of “Puritans and pornographers”—and that confusion makes fighting anti-Americanism extremely difficult.

“Puritans and pornographers” is a caricature, of course. But provided you adopt a broad definition of both Puritanism and pornography—with Puritanism standing for religion and pornography standing for popular culture—it is not an absurd one. America is a strikingly effective producer of popular culture. It not only makes more of it than any other country; it also produces more in-your-face culture—loud mouthed, libidinous and impossible to ignore. Yet it also stands out from other developed countries when it comes to resisting secularisation. America is the only modern country where most people belong to a religious organisation and where some 90% believe in God.

Arguably, America's religiosity and its popular culture spring from the same commitment to free markets. Its churches, no less than its film studios, have thrived precisely because they have never been shackled to the state and thus have to compete for customers. But whatever their common roots, pornography and Puritanism produce very different sorts of anti-Americanism.

For many Euro-secularists, America's religiosity is its least attractive characteristic. They can't believe that any modern person can be religious unless they are either stupid (Britain's *Private Eye* dubs George Bush the leader of the “Latter Day Morons”) or insane (a former German chancellor was known to accuse Mr Bush of “hearing voices”). The Pew Research Centre's survey of global attitudes last year discovered that most French and Dutch, as well as pluralities of Britons and Germans, think America is too religious.

Yet many cultural conservatives dislike America for exactly the opposite reason—because it is a battering ram for

popular culture. A few Muslims worry that America is a “Crusader state”, engaged in a religious war with Islam (a worry not helped by the suggestion after September 11th from one conservative pundit, Ann Coulter: “We should invade their countries, kill their leaders, and convert them to Christianity”). But most Muslims, and quite a number of traditional Europeans, worry far more about America's version of Mammon than about its version of God.

In some parts of the Muslim world, majorities admit to enjoying American films and music (though in Pakistan only 4% admit to such cravings). But majorities also tell Pew's researchers that they are worried about American values and lifestyles. This plays on two deep-seated worries about American popular culture: that it is hard to filter so that you just get the good bits (download Bob Dylan on to your son's iPod, and Snoop Dogg soon pops up as well) and that popular culture spawns social change. Children end up hanging around at the mall or at McDonald's rather than coming home for dinner.

Culture wars go global

What makes the “pornography” and the Puritanism so hard to take for foreigners is that America is so aggressive at exporting both of them. With pop culture, this is well documented. The perennial tedium of the Oscars ceremony won't prevent millions of people from watching it. But America is also a world-beater when it comes to exporting religion. Pentecostalism, which started off at a Bible college in Topeka, Kansas, in 1901, is now the world's fastest-growing religion, with 500m followers. There are more than 140,000 American missionaries around the world and American-style mega-churches are beginning to appear in Europe. Meanwhile, in Congress, evangelicals are taking the lead in shaping American policy on aid and human rights.

One way of looking at this is that Mr Hunter's culture wars are now going global. That is partly because the battles between pornographers and Puritans in America rivet outsiders: who could not fail to be interested in the Kansas attorney-general who wants to be informed whenever there is “compelling evidence” of sexual interaction involving teenagers in his state? But there is also a deeper reason: many other countries are having to grapple with the problems America has.

This may be most obvious in the developing world, where traditional societies will inevitably have to endure their own version of America's culture wars as they get richer. But secular Europe has also recently discovered that it has not “outgrown” religious conflict—whether it be Christians complaining about the blasphemous BBC or the continent's ever larger and more assertive Muslim population complaining about cartoons. As in so many other aspects of anti-Americanism, the schizophrenic fury against pornographers and Puritans is a twisted compliment; America is once again leading the way.

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Canadian-American relations

Ready for a thaw

Feb 23rd 2006 | OTTAWA
From The Economist print edition

Canada's new government hopes to repair relations with the United States

Get article background

FEW Canadian ambassadors have headed to Washington under quite such a weight of expectations. Michael Wilson, a silver-haired investment banker and former politician, takes up his new job in the American capital in mid-March. He has been entrusted by Stephen Harper, Canada's newly elected Conservative prime minister, with a delicate mission. His task is to rescue a bilateral relationship that has gone sour, without for a moment giving Canadians back home the impression that their new government is in any way kowtowing to the superpower.

Over the course of a dozen years of Liberal government north of the 49th parallel, Canada's access to the highest levels in Washington has been steadily eroded. Under Jean Chrétien, Canada chose not to join America's war in Iraq. Under Paul Martin, Canada decided not to participate in America's plans for missile defence. Some Canadian diplomats fret in private that Australia nowadays gets a much warmer reception in the State Department. The deteriorating relationship may not much trouble Americans, but it spells problems for Canada. The United States buys about 85% of Canadian exports and provides some 60% of its imports. In theory, a change of government in Ottawa presents a chance to mend some fences.

Mr Wilson is a shrewd choice. He held successively the finance, industry and international-trade portfolios in the Conservative government led by Brian Mulroney more than a decade ago. He therefore evokes a time when Canada and America signed two regional trade pacts and when the Canadian prime minister was proud to croon “When Irish Eyes are Smiling” with Ronald Reagan. James Blanchard, a former American ambassador to Canada, calls Mr Wilson the quintessential Canadian—“thoughtful, reserved, but very strong”. While a mite staid in public—the wooden Mr Harper jokes that Mr Wilson taught him all he knows about charisma—in his private life he goes helicopter skiing and has entertained the Stones' Mick Jagger, a fellow student at the London School of Economics.

But it will be up to Mr Harper to do the heavy lifting in rebuilding the relationship. The prime minister has made a start by promising a big increase in defence spending, along with a pledge to strengthen border and port security. The United States has long complained about a porous northern border and an inadequate Canadian contribution to continental defence. News this week that the North American Aerospace Defence (NORAD) agreement will be renewed in May, and may even be expanded to include maritime surveillance, earned Mr Harper credit in the American capital. He also stands to benefit from the previous government's decision to boost Canadian troop strength in Afghanistan to 2,200 this year, taking over part of the American mission's work in the dangerous Kandahar region. He nevertheless made a point of standing up to the United States when its ambassador in Ottawa recently criticised Canadian plans to bolster patrols in the contested Arctic.

Mr Wilson says he intends to use the same respectful but firm approach in Washington. “America is a neighbour,” he replied when asked how he intended to handle the inevitable bilateral disputes. “You don't throw snow on his driveway.” Doubtless he will bear that in mind as he tackles his priorities: resolving a two-decade-old dispute over softwood lumber exports to the United States and persuading the Americans not to implement a new law requiring passports at land-border crossings by the end of 2007.

Surprisingly, the softwood issue may be the easier one to settle. Exhausted by their battles through the tribunals of both the North American Free Trade Agreement and the WTO, the two governments want the problem, accounting for just 2% of Canada's exports to America, to go away. A deal was rumoured to be close before the Liberal government fell in November. David Emerson, who as industry minister was one of those handling the negotiations, is still in charge, having crossed the floor to become minister of trade in the Harper administration. The most likely outcome is an agreement to manage the trade, a solution used successfully in the past. Slightly more tricky is the division of the C$5 billion ($4.5 billion) in American duties levied on the Canadian imports. Mr Wilson, who as trade minister dealt with the issue in the Mulroney government, believes a deal is possible, but stresses that it won't be resolved “at any cost”.

The passport requirement is troubling for Canadians because it could create big bottlenecks at border crossings—particularly Windsor-Detroit, which is used by 16m vehicles a year. Although Canadians may find common cause with American companies and politicians in border states to fight the requirement, security-conscious America is

unlikely to allow commercial concerns to trump its own desire for tighter borders. An identity card in place of a passport has been mooted, but may not satisfy the Canadians.

As head of a minority government, Mr Harper must watch his back. He has been attacked by opposition parties for being too close to American conservatives. But a new survey shows a slim majority (54%) of Canadians in favour of a foreign policy that would bring Canada closer to the United States. Given Canada's opposition to the Iraq war, and the unpopularity of George Bush in Canada, this is surprising. Michael Adams of Environics Research, a pollster, says that Canadians are telling Mr Harper that they are giving him a chance to shape a new relationship. But the message comes with a warning: “The minute you look like you're kowtowing, as far as we're concerned, you're toast.”

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Colombia

Cloak and machete

Feb 23rd 2006 | BOGOTÁ
From The Economist print edition

The disturbing political muscle of the right-wing paramilitaries

AP

Surrendering his arms, but not his influence

Get article background

TEARS rolled down the faces of Rocío Árias and Eleonora Pineda, two congresswomen who openly support the country's right-wing paramilitary groups, as they announced their expulsion from Colombia Democrática, one of President Álvaro Uribe's main supporting parties. They felt baffled and betrayed, they said. They need not have worried. Like half a dozen other candidates ousted from big-party lists for alleged links with the paramilitaries, they were soon snapped up by lower-profile pro-Uribe parties to stand in the legislative elections on March 12th.

The two women accuse America of being behind their ejection. Its embassy in Bogotá had threatened to revoke the visa of Mario Uribe, Colombia Democrática's leader and the president's cousin, unless he removed them from his list, they say. In a carefully worded statement, the American State Department insisted that it had not “instructed” its embassy “to intervene in the selection of candidates”. But Colombians remain unconvinced.

There are two main groups of armed militias in Colombia, the left-wing FARC rebels and the pro-government United Self Defence Forces (AUC), commonly known simply as the paramilitaries. Both have committed the most appalling atrocities. Paramilitary influence in Colombian politics is not new. After the 2002 election, Salvatore Mancuso, the AUC's leader, proudly announced that the paramilitaries now “controlled” 35% of Congress. While this was almost certainly an inflated estimate of their influence, it may reach that level in the next parliament.

When the present campaign began, several demobilised AUC leaders sought to launch their own candidacies. Ernesto Báez, a legendary AUC figure, even suggested that the government reserve two special seats for them. More than 22,000 paramilitaries have already laid down their arms in exchange for a government promise of reduced sentences for those guilty of the most serious crimes. But until the entire AUC has been demobilised, all paramilitaries are barred from politics.

This has not stopped the AUC from continuing to work behind the scenes. Mauricio Romero, one analyst, says that the paramilitaries have never played such an important role in an election; nor have the stakes for them ever been so high. The next Congress is likely to be asked to outlaw extradition to the United States, where nine of the AUC's leaders are wanted on drug-trafficking offences. It will also have to flesh out the details of the government's peace pact with the paramilitaries. The Justice and Peace law, which still has to be approved by the Constitutional Court, is facing dozens of legal challenges and may have to be radically amended.

An accurate measurement of paramilitary influence in Colombian politics is not easy. Claudia López, a Colombian journalist, tried to gauge the extent of their infiltration by studying atypical voting patterns in the last election. In areas where the AUC had consolidated its power through massacres, she found that political newcomers often won by overwhelming landslides. It may not constitute proof, she admits, but it does suggest a disturbing trend.

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Argentina

The price is wrong

Feb 23rd 2006 | BUENOS AIRES
From The Economist print edition

Argentina's fight against its economic bête noire, resurgent inflation

Get article background

MANY developed-world policymakers might envy Felisa Miceli, Argentina's economy minister. When she took over in December, she inherited a thriving economy which had been growing at an annual rate of around 9% for the previous three years. But if the relatively inexperienced Ms Miceli, chosen primarily for her loyalty to President Néstor Kirchner, is unable to bring the country's resurgent inflation into line within the next 12 months, Mr Kirchner might decide to distance himself and perhaps even use her as scapegoat—lest Argentina's monetary troubles be left at his own political doorstep.

After two relatively calm years with annual inflation averaging less than 5%, consumer prices rose 12.3% in 2005 and a further 1.3% in January. Some of the causes are beyond the government's control. The relative costs of many goods are still adjusting after the country's 2002 currency devaluation, for example, and higher international demand for Argentina's commodity exports have raised local prices.

But other drivers of inflation, notably the 22% hike in federal government spending in the run-up to last October's legislative elections, are the result of the president's populist tendencies. On the monetary front, his desire to keep the peso artificially cheap—thereby maintaining the competitive advantage enjoyed by Argentinian exporters and domestic import-substituters—has forced the central bank to print more pesos in order to buy American dollars, thus increasing the money supply and fuelling inflation. Meanwhile, his business-bashing rhetoric and continued price controls have discouraged large investments, causing capacity constraints which have likewise pressured prices upwards.

A history of hyperinflationary spirals makes price rises particularly sensitive in Argentina. Mr Kirchner has declared inflation control to be his priority for 2006. (Ms Miceli, who before taking over as economy minister dismissed concerns over inflation as “an argument to maintain low salaries”, has now recast herself as an inflation hawk.) So far, however, his strategy has consisted largely of a host of short-term price-freezing pacts with retailers and some suppliers. Typically, these have been extracted either by the carrot of implied government support in forthcoming labour negotiations or by the stick of threatened tax increases. But their primary role appears to be to contain short-term inflationary expectations while awaiting a promised return to fiscal austerity. “Kirchner seems to think that businesses raise prices just because they can unless someone tells them no, so he tells them no,” says Javier Alvaredo, an economic consultant.

After last year's election-fuelled spending spree, the 2006 budget projected a rise of only 2% in federal expenditure, boosting the primary surplus from 3.2% of GDP last year to a beefier 4.1%. If this target is met, it should put a brake on prices as well as help position the government to handle a new external shock or the next economic downturn. But the prudence promised on the fiscal side is nowhere to be found in monetary policy. Mr Kirchner has failed to use his sway over the central bank to support a meaningful increase in interest rates, which remain at a negative 7% in real terms. And he has turned the highly inflationary 3:1 peso-dollar exchange rate into a virtual trademark of his presidency. But until Argentina accepts positive real interest rates, prices will continue to rise.

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Mexico's presidential elections

The sinking of a flagship

Feb 23rd 2006 | MEXICO CITY
From The Economist print edition

Could Mexico be heading for a coalition government without the PRI?

Get article background

MEXICAN politics have long been characterised by a lack of ideology. The Institutional Revolutionary Party (PRI) managed to rule the country for 72 successive years by adopting a single guiding principle: stay in power. That finally failed when Vicente Fox, from the centre-right National Action Party (PAN) won the presidency in 2000 with the slogan "Change!" But his administration has proved a bit of a disappointment, due largely to a congressional deadlock between the three major parties which has blocked much of the promised change. In elections over the past three years, the PRI has performed well, raising party hopes that Mr Fox's six-year term was but an interregnum.

This now seems unlikely, however. Most polls for the presidential elections, due to be held on July 2nd, give Roberto Madrazo, the PRI's candidate and a former party leader, around a quarter of the vote, trailing both Felipe Calderón, PAN's candidate, and Andrés Manuel López Obrador, a former mayor of Mexico City and candidate of the centre-left Party of the Democratic Revolution (PRD). Some polls put the two frontrunners neck and neck, while others have Mr López Obrador, for long the favourite, maintaining a slight lead.

A few trends are clear, however. The first is that Mr Calderón—who was not Mr Fox's choice as PAN's candidate, but came from behind to win the party's primaries—is on the upswing. The second is that Mr Madrazo's campaign has gone into a downward spiral. The series of scandals that have rocked the PRI, coupled with Mr Madrazo's lack of appeal to voters, have led most members of even his own party to doubt he can win. This means lukewarm support from both gubernatorial and congressional candidates, which will make the going even tougher for him.

"PRI-tanic!" is how Porfirio Muñoz Ledo, a former head of the PRI who now works for the rival PRD, gleefully sums up the situation. To be sure, the PRI is not the only party that has had to deal with corruption scandals. Several of Mr López Obrador's close aides were caught on videotape accepting large bundles of cash in 2003, though he personally appears to have escaped unscathed. The sons (from a previous marriage) of Marta Fox, the president's wife, have been accused of milking their political status for money. But, as Mr Calderón was not Mr Fox's preferred candidate, he feels sufficiently removed to be able to say tartly: "I take responsibility for no one's children but my own."

Mr Calderón has been spending four times as much on his campaign in the media as his two main rivals. As the business community's preferred candidate, he is likely to be the best funded. All officially recognised party campaigns receive generous public support, while private donations are supposed to be closely monitored by the independent Federal Election Institute (IFE). But although there is little worry about the integrity of the actual vote, Mr Muñoz Ledo seems close to the mark when he describes IFE's performance in regulating campaign finance as "not even a paper tiger, a Kleenex tiger". IFE officials themselves admit they have little control over the country's two main television networks, which will account for a large chunk of all the campaign's costs. A blitz of advertisements by Mr Fox over the last few months—which purport to be public-service advertisements and are paid for as such—are thinly veiled campaign ads for PAN. But so far IFE has taken no action against Mr Fox.

What is perhaps surprising is that there is little of substance at stake in the elections. Even with rivalry developing between centre-left and centre-right parties, ideology has little importance. "It will not be an election decided on policy proposals," Manuel Camacho, a close adviser to Mr López Obrador, says firmly. That is because all three candidates not only agree on what the main issues are—the economy and crime—but also largely agree on what needs to be done: stimulate growth and get tough on criminals. So the election has become primarily a contest of credibility: who can be trusted to follow through best on proposals that are basically quite similar?

But the very consensus on the issues means that this election could bring about the sea-change in Mexican politics which many voters had hoped for when they elected Mr Fox. Under his minority administration, change did not come largely because he was unable to persuade a divided Congress to pass much of his legislation. Now both Mr Calderón and Mr López Obrador have begun talking openly of persuading some PRI deputies to form a governing coalition. Mexico is in sore need of structural reforms on many fronts: the tax system, the energy sector (Pemex, the state oil monopoly, currently accounts for over one third of government revenue), the justice system,

education and pensions, to name only those areas most in need of overhaul. If a coalition were formed, it might just be possible that the next president, be he Mr Calderón or Mr López Obrador, could push such changes through Congress. If so, whatever the outcome of the campaign, Mexico could end up as the real winner.

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South-East Asia

All serene

Feb 23rd 2006 | BANGKOK
From The Economist print edition

AP

Our correspondent is leaving South-East Asia after four years. He reports that politics and economics there have never seemed so smooth

AS LAST year's statistics trickle in, it is becoming clear that almost all South-East Asia's big economies grew by over 5%. Governments around the region are forecasting much the same for 2006. If they are correct, this will be the third straight year of steady expansion. Only Thailand, which has not yet published an official growth figure for 2005, is likely to lag behind, at a mere 4.7% or so. For a region that suffered a deep recession after the Asian financial crisis of 1997, and several years of see-sawing economic fortunes after that, the last few years have proved surprisingly stable and prosperous.

Much the same could be said of South-East Asia's politics. The crisis overturned the established political order altogether in Indonesia and Thailand, and shook it to the core in Malaysia. Even the docile citizens of Singapore began grumbling when their normally buoyant economy went into recession in 2001. Since then, however, relatively young, popular new leaders have come to power in Indonesia, Malaysia and Thailand, not amid protests and putsches, but by normal democratic means. South-East Asia, in short, is becoming hearteningly staid.

For several years after 1997, the fallout from the crisis dominated public life. Governments suddenly found themselves taking over failed banks, and attempting to restructure them or sell their assets. In the process, they were saddled with huge debts, which they struggled to finance. Foreigners wanted to take advantage of the region's devalued currencies and foundering conglomerates to buy up local firms on the cheap. Local businessmen, naturally enough, wanted protection from such depredations. Humbler folk struggled with stubbornly high unemployment and poverty. These thorny issues displaced the previous bickering over the spoils of rapid economic growth as the focus of policy-making.

Thaksin Shinawatra, Thailand's prime minister since 2001, promoted the idea of “asset reflation”—a souped-up form of fiscal pump-priming—as a means for his country to escape the economic doldrums. Successive Indonesian governments, in more dire financial straits, battled long and publicly with the International Monetary Fund (IMF) over the conditions of its loans. Malaysia, for its part, defied the received financial wisdom and imposed currency controls, while fixing its exchange rate.

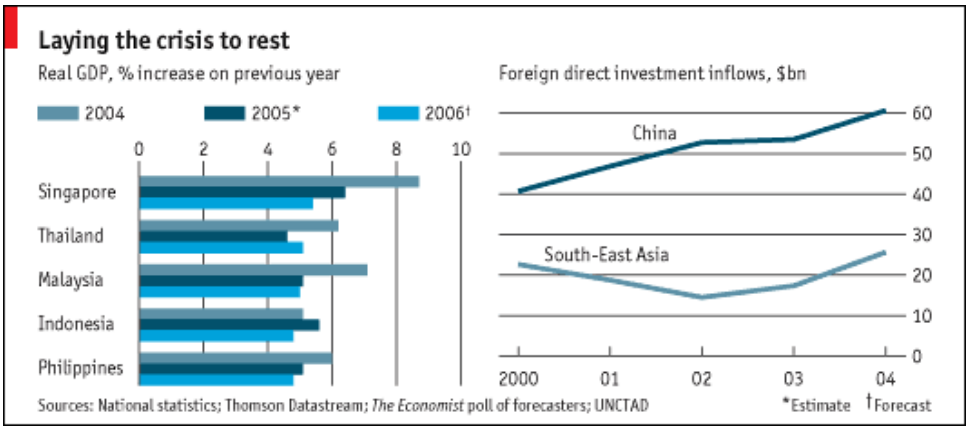
These controversies have now played themselves out, by and large. State-run corporate restructuring agencies have shut up shop or adopted new mandates. Last year, Malaysia dismantled the last of the contentious measures imposed in the aftermath of the crisis, by allowing its currency to float. Thailand, where big current-account deficits in the run-up to the crisis had bred paranoia about the balance of payments, slipped quietly back into the red last

year for the first time since 1996. Also in the past year, Indonesia's constant lament about a sustained fall in investment since the crash turned to celebrations, as the numbers finally began to pick up.

Nowadays, debate tends to focus on the finer points of economic management. In Malaysia, for example, the decision to float the ringgit was overshadowed by a blazing row over the allocation of permits to import cars—hardly an issue on which the fate of the economy hinges. Thais have taken to the streets recently to protest the listing of a big brewer on the stock exchange, the privatisation of an electricity firm and suspected corruption in government, but not the overall direction of the economy.

Even the heated debate over co-operation with the IMF and other meddling foreigners seems to have lost much of its resonance. A year or two ago, ritual denunciations of the Fund were a staple of public life. In 2003, Ad Carabao, one of Thailand's most famous musicians, dredged up the subject in the middle of a demonstration against America's invasion of Iraq. The same year, Mr Thaksin held a rally of his own to celebrate Thailand's early repayment of its IMF loans, or Thailand's "independence", as he grandly put it. But Mr Thaksin must believe that nationalist sensitivities have subsided somewhat since then, or he would not have allowed his family to sell most of their business interests to the government of Singapore.

Indonesia, admittedly, is still toying with the notion of paying off its IMF debts early. But the finance minister floating the idea used to work for the Fund herself, and her decision seems to rest more on financial than populist grounds. There are still gripes about the many free-trade deals under negotiation, and about foreigners buying strategic assets, but the "Washington consensus" of fiscal conservatism, floating currencies and open markets is fast becoming a South-East Asian consensus as well.



The region has mellowed politically, too. In Malaysia, for instance, the fate of Anwar Ibrahim, a former finance minister who was jailed after breaking ranks with the government, dominated the political debate for years. Yet Mr Anwar's release in 2004 created barely a ripple. The policies he had championed from his prison cell, including reform of the ruling party and an end to extravagant and corruption-prone building projects, had already been adopted by Abdullah Badawi, Malaysia's prime minister since 2003.

Singaporean officials have become less stern with their own citizens. Singaporeans can now chew gum, read *Cosmopolitan* and dance on bar tops. Soon, they will be able to gamble too, thanks to the authorities' decision to license two casinos. Instead of simply scolding voters, the government has taken to pandering to them: it will run a budget deficit in the run-up to the next election, to pay for a series of one-off hand-outs.

The most remarkable political transformation of all has taken place in Indonesia, which churned through three presidents in quick succession following the ouster of long-serving strongman Suharto in 1998. Pundits had worried that the country might disintegrate or implode, thanks largely to its incompetent and self-serving politicians. Megawati Sukarnoputri, the previous president, dispelled these fears to some extent, by restoring macro-economic stability. But her efforts to rationalise government spending, by cutting fuel subsidies, and to negotiate an end to the secessionist rebellion in Aceh province both came to naught.

Yet in just over a year, Susilo Bambang Yudhoyono, Indonesia's current president, has managed to bring peace to Aceh and raise fuel prices with relatively little fuss. Moreover, Mr Yudhoyono's rise to the presidency was just one element of a broader political evolution. In the run-up to the election of 2004, many wondered whether Indonesians would be able to organise a fair and peaceful vote, let alone elect anyone competent. But Indonesia now holds direct elections not just for the national and regional parliaments, but also for president, governors, mayors and district chiefs. Although incumbents still have an advantage, voters have not hesitated to throw out the most obvious rascals, just as they threw out Miss Megawati when she ran for re-election in 2004, judging her not up to the job. The odds of Indonesia defusing its various sectarian, regional and class tensions peacefully have greatly increased as a result.

Politics still looks somewhat precarious in Thailand and the Philippines: Mr Thaksin is facing growing calls for his

resignation, despite his party's landslide re-election last year, while foes of Gloria Arroyo, the president of the Philippines, have sought to impeach her on charges of rigging her election in 2004. But even in these cases, events are taking a more sedate turn than they might have a few years ago. “People power” protesters have not managed to unseat Mrs Arroyo, as they did her predecessor, Joseph Estrada. Mr Thaksin's survival, meanwhile, is testimony to the stability ushered in by Thailand's constitution of 1997. The sort of self-serving MPs who used to topple past governments on a whim cannot defect from Mr Thaksin's without losing their jobs.

There is one critical way in which the region still seems to be struggling, however. Before the crisis, South-East Asia used to attract more foreign investment than China. Now China rakes in more than twice as much. Perhaps, if the region remains on such a steady keel, that too might eventually change.

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Japan's economy

Picking itself up

Feb 23rd 2006 | TOKYO
From The Economist print edition

The recovery is spreading, by and large

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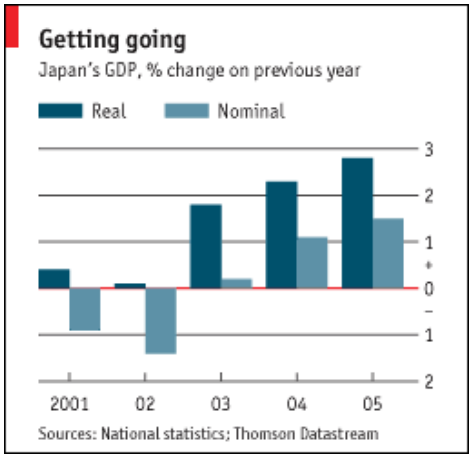

IF THE latest figures are to be believed, then last year, Japan (yes, Japan) grew faster, at 2.8%, than any G7 economy except America. And as of the final quarter of the year, it was growing faster than America as well, clocking up a 4.2% growth rate, year-on-year. Japan's GDP figures are notoriously prone to revision, so some of the shine may yet come off last year's performance. What is not in doubt, though, is that Japan's recovery is solid and increasingly broad-based.

In the recovery's early stages, rapid export growth played a crucial part in boosting industrial production and so company profits. After a soft patch early last year, export growth has accelerated again, with demand from China particularly strong. But what is striking now is the recovery in domestic demand. Companies with growing order books are spending on capital goods: fixed-capital investment grew at an annualised 7.2% in the last quarter of the year, while the outlook for machinery orders looks buoyant. Companies need to hire more workers. So the availability of jobs continues to grow. For the first time in over a decade, for instance, Japan has as many jobs on offer as there are applicants. Demand for workers is pushing up wages, and that is now clearly being felt in the shops. In the last quarter of 2005, personal consumption jumped sharply, growing at an annualised 3.2%. Department stores in and around Tokyo report brisk winter sales, and the first retail growth in nine years looks set to continue.

Confidence is returning to the housing market, too. New housing starts are holding up in the face of heavy winter snows, as well as a confidence-sapping scandal involving faked earthquake-resistance data for condominiums. And after a period when the housing recovery was confined chiefly to the Tokyo area, it has now spread to other parts, notably around Osaka and Nagoya. Thanks partly to the demand for mortgages, bank lending is starting to pick up again for the first time in years. With Japan pulling out of deflation, the Bank of Japan is likely to begin winding down its policy of super-loose money as soon as March or, more likely, April.

What are the dark spots in this picture? Taking a mildly contrarian stance, Richard Jerram, Japan economist at Macquarie Research, finds a couple. One is fairly soft import growth for such a purportedly robust recovery. This in part reflects the extent to which the recovery is taking place not chiefly in the manufacturing sector, but rather in services, where import demand is relatively low.

A second, more worrying, blot, is that for all that the labour market has tightened over the past year, employment growth, at an annualised 0.5%, is still too sluggish. This, says Mr Jerram, could point to a skills mismatch in the economy, where people are insufficiently suited for the kind of jobs being offered; if he is right, then the situation is not likely to improve anytime soon.

The employment picture also has a strongly regional element to it. In Tokyo, one-and-a-half jobs are being offered for every applicant: but in Hokkaido and Kyushu, Japan's northernmost and southernmost big islands, there are still too few on offer. To that extent, the fruits of the recovery are sure to be shared unevenly.

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The Philippines

A deadly tide of mud

Feb 23rd 2006 | MANILA
From The Economist print edition

Another tragedy strikes the unlucky Philippines

AP

The village vanished

RESCUERS dug for days in an effort to find survivors of a landslide that buried the village of Guinsaugon on February 17th. When they first saw how the side of a ridge high above the village had collapsed, after days of extraordinarily heavy rain, covering nine square kilometres (3.5 square miles) in mud and rock to a depth of up to 30 metres (100 feet), they felt powerless. The feeling of impotence gave way to despair when, five days later, they had found fewer than 125 corpses and no trace of about 1,000 villagers.

Impotence and despair also pervaded subsequent public discussion about how to prevent similar catastrophes. Between them, man and nature have made the Philippines, according to the International Red Cross, one of the world's most disaster-prone countries.

Guinsaugon sat below a ridge, on the island of Leyte, formed by one of the geological features that make the country susceptible to earthquakes and volcanic eruptions. It was to the island's east, right in the path of the two dozen typhoons or lesser storms that come every year. These bring torrential rainfall that causes floods and landslides—rainfall exacerbated this year by the climatic phenomenon called La Niña. The Philippines has lost almost all its natural forest to logging, legal and illegal, and to slash-and-burn peasant farmers as the land struggles to accommodate a population of 85m that depends mostly on agriculture.

The government's immediate response was to announce extra spending on a survey meant to identify settlements at risk from natural calamities. The hope is that these can be evacuated, either permanently or when threatened. But experience has shown this approach to be flawed. In far-flung provinces, where the authorities often fail to provide for their security in any other respect, people are reluctant to abandon their livelihood simply because a government scientist says they should. And even if they agree to leave temporarily, they often return before the danger has passed, for fear of looting.

There has been little mention of how a fast-growing population puts pressure on the environment and so adds to the risks. At the present rate of growth, the population of the Philippines will double by 2034. Successive governments, deferring to the church in what remains a staunchly Catholic country, have done little to promote contraception.

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Cambodia

A sudden outbreak of niceness

Feb 23rd 2006 | PHNOM PENH
From The Economist print edition

Hun Sen's change of heart

THESE are bewildering times for followers of Cambodian politics. Opposition supporters, treated for years to vitriolic attacks accusing the prime minister, Hun Sen, of everything from corruption to murder, are now being told by their once abrasive leader Sam Rainsy that “We are no longer enemies, but partners in dialogue.”

Earlier this month, Mr Rainsy made a dramatic return from exile. A year before, he had fled to France after being stripped of his parliamentary immunity. In December, he had been sentenced to prison for 18 months, in absentia, for defaming Hun Sen and Prince Norodom Ranariddh, the president of the royalist party. But the sentence was overturned by royal pardon, on the prime minister's recommendation.

Mr Rainsy announced on his arrival back in Phnom Penh that his bitter personal disputes with Hun Sen had been discarded, and specifically recanted his claim that the prime minister was behind a deadly grenade attack in 1997 and other violence against his party. The man who used to fear assassination by Hun Sen's security forces now enjoys the protection of 12 bodyguards from the ministry of interior.

Mr Rainsy's case last year was the precursor to worse. Five outspoken critics of Hun Sen were jailed and others prudently fled during a government crackdown in December and January. The arrest of a prominent human-rights activist, Kem Sokha, soon after Christmas, sparked an international outcry. But in response to outside pressure and with a weather eye on an annual conference of donors due in Phnom Penh next month, Hun Sen, Asia's longest-serving prime minister, has shifted gears. The five dissidents were released, Mr Rainsy is back and Hun Sen has agreed to get rid of the law on criminal defamation that was used against him.

Cambodia's unpleasantly confrontational politics could do with a change. But many human-rights groups think it is too soon to celebrate. True, Cambodia is not exactly a totalitarian state: it has a free press and is home to plenty of human-rights NGOs. But Kem Sokha, recently freed from prison, calls Cambodia's a yo–yo democracy. “Democracy is in the hands of the prime minister,” he says. “He can give it and he can take it away at any time.”

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Egypt, the Americans and Arab democracy

Who's isolating whom?

Feb 23rd 2006 | CAIRO
From The Economist print edition

Despite their fear of Iran and of Islamist movements at home, most Arab regimes seem loth to co-operate wholeheartedly with America in the region

Get article background

YOU can't have it both ways, is what America's secretary of state, Condoleezza Rice, is telling Arab audiences during a tour of friendly capitals to rally sagging support for American policy in the Middle East. You can't preach violence and expect international aid, she says of Hamas, the Islamist party that recently swept Palestinian elections. No one will respect you if you signal reform but act repressively, she advises Egypt's president, Hosni Mubarak. You can't say in private that you fear Iran going nuclear but do nothing to stop it happening, she will tell Gulf leaders.

Yet Ms Rice is hearing much the same refrain in response. America cannot preach democracy in Palestine, then chastise the winners, just as it cannot demand concessions from Hamas without Israel budging, too. It cannot bully dictatorial allies to reform, then always expect their support. And America cannot single out Iran on the nuclear issue, while ignoring Israel's nearby arsenal. It's like Dick Cheney hunting quail but shooting his friend instead, joked a Saudi columnist.

Stark as they are, differences between America and allied Arab governments, across the range of issues on Ms Rice's agenda, mask a degree of convergence. Egypt, for example, says it agrees that Hamas should meet such conditions as accepting previous Palestinian peace commitments, recognising Israel's right to exist and renouncing resort to violence. Egypt's government, stunned by the strength of the Muslim Brotherhood in recent national elections, dearly wishes to thwart the political advance of closely related Islamist groups such as Hamas.

What Egyptian officials fear is that too much pressure, too soon, could drive Hamas into further extremism. Instead of making threats, say the Egyptians, outsiders should bolster Palestinian institutions that are not run by Hamas, such as the presidency of Mahmoud Abbas, and give Hamas itself time to sort out a more practical, less ideology-bound position. “I'm sure Hamas will develop, will evolve,” Egypt's foreign minister, Ahmed Abul Gheit, said at a joint conference with Ms Rice, “We should not prejudge the issue.”

As for internal reform, the signs are that it is America that is muting its demands. Last time Ms Rice was in Cairo, in June, she appealed for Egypt to lead the region in democratisation. Since then, Egypt has held presidential and parliamentary elections, but both were marred by massive fiddling. In recent weeks, Egypt has jailed a candidate who challenged Mr Mubarak for the presidency, summarily postponed local elections due in April, mounted pressure on judges who protested against vote-rigging under the country's notorious emergency laws. During the elections some 1,500 Muslim Brothers were arrested; most were set free quite soon, but a score or so remain behind bars.

The Bush administration has responded by suspending talks on a bilateral free-trade agreement. Yet in Cairo Ms Rice contented herself with expressing disappointment at “setbacks” to reform, which she said fell within a context of continuing progress and friendly dialogue. Despite signs that America's western allies are inching towards talks with the Brothers, the Bush team remains wary of offending Mr Mubarak's regime by courting the rising party, which has yet to be made legal. The underlying signal, it seems, is that the Bush administration deems the regional situation too precarious, in the short run, for the kind of hasty experimentation that might weaken occasionally useful friends such as Mr Mubarak.

On the issue of Iranian nuclear power, the two sides appear to have agreed to disagree. Arab countries will not actively support Iran, a country that all regional governments, bar Iranian-allied Syria, regard as meddlesome and dangerous. Most will probably go along with multilateral actions, through the UN or its agencies, that seek to curb Iran's ambitions. Yet even Saudi Arabia, a country that has skirmished militarily with Iran in the past and sees itself as a Sunni rival to Shia Iran's pretensions of Islamic leadership, says bluntly it will not openly challenge Iran.

Yet while most Arab governments may achieve fudges on such issues with the Bush administration, the public mood across the region continues to head towards polarisation. America's unpopularity seems only to grow as Iraq remains chaotic, and now the cartoon controversy has tainted the West's relatively “good cop”, Europe, with a similar perceived animosity towards Arabs and Muslims. Bolstered by its electoral performance and sensing a surge of pan-Islamic feeling, the Muslim Brotherhood has laid down a challenge by announcing a campaign to secure donations from Muslims around the world to replace western aid to Palestinians.

That call was echoed in Iran, where Hamas's most telegenic leader, Khaled Mishal, condemned financial “blackmail” this week, declaring that funds from Arab and Muslim countries would make western aid redundant. Iran's president chipped in, suggesting helpfully that “Since the divine treasures are infinite, you should not worry about financial issues.”

So far, no significant substitute cash has made its way to Hamas. But should such cash start to flow, Arab governments would find it hard to stand in the way. Obviously, an even starker Muslim-western division over the eternally-divisive Palestinian issue could muck up other parts of America's regional agenda. This could, if not handled with care, make Mr Bush's administration look more isolated than Iran and its fellow rejectionists.

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Iran

Fund and find your opposition

Feb 23rd 2006 | TEHRAN
From The Economist print edition

It will be hard for a real opposition to emerge, even with American cash

Get article background

AP

Unopposed Ahmadinejad

PITY those Americans, George Bush among them, who long for their ideas about democracy to take root in Iran. Mindful of the mistake that his and earlier administrations made in backing Iraqi exile groups that turned out to enjoy scant support back home, and aware that, for Iran's democracy-seekers, gifts from America carry the taint of collusion with the enemy, Mr Bush has often encouraged Iranians to strive for "the freedom they seek and deserve"—and pretty much left it at that. Until this month, that is, when his secretary of state, Condoleezza Rice, asked Congress to pledge $75m to the cause.

That is a big increase on the $10m previously budgeted. It is also a statement of intent by an administration often accused of having no clear policy on Iran. Helping to establish a "different system", a goal identified by a senior American official after Ms Rice's testimony, is a short rhetorical step from the "regime change" to which some American hawks want Mr Bush to commit.

So America's challenge now is to find suitable NGOs, trade unions, human-rights groups and students to receive the $20m they have been allocated. (The other $55m will help disseminate Persian-language broadcasts and propaganda on the internet.) Iran's internal opposition lacks a Nelson Mandela; Iranians in the diaspora (1m in the United States) cannot even boast of an Ahmed Chalabi, the neo-conservatives' failed favourite to run Iraq.

Citing infiltration of Iranian NGOs by government agents, the same official predicted that the awards would go to groups based outside Iran. Anyone doubting that his call for unity among expatriates will be hard to realise need only surf the 20-odd Los Angeles-based Persian-language television channels which can be viewed by owners of satellite dishes in Iran. From brilliantined monarchists and religious eccentrics who have not seen Iran since the 1979 revolution, to youthful music presenters who have not seen it at all, they have little in common save their dislike for the Islamic Republic.

Even supposing the promise of cash moves the diaspora to unite, the credibility of its leading lights is low. Though he has astutely backed calls for a referendum on a political system to replace the Islamic Republic, Reza Pahlavi, the personable but reputedly unambitious son of the last shah, is little spoken of in Iran.

As for the People's Mujahideen Organisation of Iran (PMOI), which sided with Saddam Hussein during his war with Iran in the 1980s and is officially considered a terrorist organisation by the United States and the European Union, it is widely despised by Iranians back home, millions of whom lost relatives in that war. The group fosters a cult of personality around Maryam Rajavi, wife (probably widow) of its long-time leader. There is growing support in the United States and Europe for removing the terrorist label attached to the PMOI, which is widely credited with having exposed several of the nuclear-research facilities the Iranian government had kept secret for many years. But that may not endear it to people in Iran either.

Ms Rice cannot even count on the relatively pro-American sentiment that most ordinary Iranians evinced during the calmer Clinton presidency. While no reliable opinion poll has been carried out on the subject, anecdotal evidence suggests that Iranians' scepticism of American motives has risen since the invasion of Iraq. Mr Bush's determination to prevent the Iranians from becoming producers of nuclear fuel that would, if they wanted, enable them to make a bomb has piqued nationalists. This month, bigger-than-usual crowds gathered in Tehran, Iran's capital, to commemorate the revolution's anniversary and shout "Death to America!"

The president's nationalist tailwind

The combination of a protracted international crisis and last summer's election of a hardline president, Mahmoud Ahmadinejad, has allowed Iran's conservative establishment quietly to bury the reform movement of Muhammad Khatami, Mr Ahmadinejad's predecessor. Their most interesting newspapers banned and their leading lights silenced or jailed, the reformists have even fallen in line behind the hardliners' tough nuclear diplomacy. The once-vibrant student movement is moribund. In the face of “undemocratic actions”, laments Mehdi Makaremi, a reformist columnist, student bodies content themselves with “issuing statements”.

By banning adventurous newspapers and filtering websites, the authorities have denied publicity to political prisoners such as Akbar Ganji. Five years ago, this outspoken critic of the ruling theocracy was on everyone's lips; now, despite spending much of last year on hunger strike, he has slipped from public view. In a land of high unemployment and few effective trade unions, industrial unrest is rare; strikes are dealt with decisively, and often before they happen. A recent protest by bus drivers in Tehran, the capital, was pre-empted with hundreds of arrests; the disgruntled drivers, back at work, have been promised better conditions.

Not about to boil over yet

So Iran is not the hothouse of dissent that American hawks depict. It may indeed, in the words of one of its leading literary dissidents, be “bereft of any effective opposition, legal or illegal”. But that does not mean that everyone is content: only that frustrations, inadequately addressed by Mr Khatami, express themselves in different ways. Threats now come from two currents, religious heterodoxy and separatist nationalism, that have intermittently irritated the Islamic Republic, a Shia state run by ethnic Persians, since its inception.

Two regions bordering Iraq, Kurdistan in the north and Khuzestan on the Persian Gulf coast, are rumbling. For the mostly Sunni Kurds, the Khatami presidency, which they hoped would usher in religious and political autonomy, was a disappointment; many now covet the quasi-independence being enjoyed by their Iraqi cousins across the border. Since the shooting last summer of a dissident at the hands of the security forces, and subsequent unrest in Kurdish towns, there have been reports of sporadic attacks on soldiers by Kurdish militants.

Iran's interior minister says he detects a British hand behind last month's explosions in the oil-rich, partly-Arab province of Khuzestan, which killed seven people. Last year, Khuzestan suffered sectarian rioting and other deadly blasts; these, too, were blamed on the British, who run a neighbouring chunk of southern Iraq. The British deny these outlandish accusations.

Iran's clerical establishment is increasingly exercised by the Nematullahi-Gonabadi order of Sufis, Muslims who neglect some Shia practices in favour of a mystic relationship with God. The order claims to have more than 1m members, many with deep pockets, in Iran and abroad. Last week the authorities destroyed a prayer hall erected by the Sufis in the shrine city of Qom; there were reports of serious injuries and some 1,000 Sufis were briefly arrested. Repression, say the order's supporters, will only increase its popularity. At last, music to George Bush's ears—though the Sufis may not qualify as an NGO deemed worthy of cash from America.

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Iraq

Ever more sectarian

Feb 23rd 2006 | DUBAI
From The Economist print edition

Could the bombing of a Shia shrine tip the country into full-blown civil war?

Get article background

Reuters

Symbol of strife

THIS week's bomb in the city of Samarra, which severely damaged the Askariya shrine, one of the four holiest for Iraq's Shia Muslims, was the most provocative attack on a Shia religious target since the American invasion three years ago. As a result, fears of an out-and-out sectarian conflict have risen.

Within a day, a menacing wave of reprisals ensued. At least 130 people were killed in sectarian violence in Baghdad and other towns, and at least a score of Sunni mosques, especially those whose clerics preach a puritanical, anti-Shia message, were attacked. One Sunni leader put the figure at 90.

Beneath the Askariya shrine's shattered golden dome lie several of the Prophet Muhammad's descendants, including the Shias' tenth imam and his son, the 11th, who died in 873AD—the last before the 12th and final “hidden” imam, who is said to have disappeared into “occultation” in Samarra and whose return is eagerly awaited when the world ends. Nothing could be more calculated to inflame sectarian hatred, just as Iraq's politicians are struggling to create a broad new unity government.

For once, it was uncertain whether calls for restraint by Grand Ayatollah Ali al-Sistani, Iraq's most influential Shia cleric, who has constantly sought to ensure that Sunni extremists' attacks on Shia targets do not unleash communal violence, would be heeded as before. Followers of a more radical Shia cleric, Muqtada al-Sadr, seemed poised to take matters into their own hands. Various Shia militias seemed bent on revenge.

Much depends on Mr Sadr himself. Several radical Shias, reckoning that their leaders might be more able to impose their authority on the country if the Americans and their allies were to leave forthwith, blamed the Americans. Abdul Aziz al-Hakim, leader of the Supreme Council for Islamic Revolution in Iraq (SCIRI), a key part of the ruling Shia alliance, accused the American ambassador, Zalmay Khalilzad, of “giving the green light” for the attack. A prominent Shia even accused the Americans of organising the shrine's bombing.

The Americans have been pressing the Shias to exclude the current interior minister, a SCIRI man, from the emerging government because Sunnis accuse him of overseeing death squads against them. This has infuriated many Shia leaders, some of whom are beginning to think they could do without the Americans seeking to hold the ring. The attack on the shrine may harden such thinking.

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Palestine

A tricky jigsaw

Feb 23rd 2006 | JERUSALEM AND RAMALLAH
From The Economist print edition

Even if Hamas gets less cash for running a government, it may not get weaker

AP

Hamas's honey-worded Haniyeh

THE slow process of taking over the Palestinian Authority (PA) has begun for Hamas. This week the Palestinian parliament, in which the Islamist movement won 74 of 132 seats in last month's election, was sworn in. Ismail Haniyeh, a Hamas leader from Gaza known as a centrist within the movement, was named prime minister. He has until March 28th—the same day that Israel holds its own election—to appoint a cabinet. Hamas is now talking to other Palestinian factions, hoping to form a national unity government.

It may yet succeed. Though most in the defeated secular party, Fatah, want Hamas to shoulder the burden on its own in the hope that it will quickly fail, a handful, worried that Palestinians will be the ultimate losers, now talk openly of joining it. Otherwise, Hamas says it will appoint non-political "technocrats" to the cabinet—though how many and to which posts is vague.

Equally unclear is whether this would make Hamas less isolated. Its main opponents, Israel and the United States, have taken harsh steps already. Israel says it will stop transferring the customs and tax revenues it collects on the PA's behalf after the PA government is formed. American legislators voted overwhelmingly (but non-bindingly) to stop all aid as long as the PA is run by a party that calls for Israel's destruction; the United States asked the PA to give back $50m of unspent money from last year. And Condoleezza Rice, the secretary of state, spent this week on a tour of the region, to persuade Middle East governments not to help the PA; Hamas's leaders had been on a regional fund-raising drive shortly before.

But behind the scenes, Israeli decision-makers are in a quandary. Politics in the run-up to their own election is making them sound tough. They may perhaps soften afterwards if the informal suspension of hostilities between Hamas and Israel, which has mostly held for the past year, continues. And the American government, says Nathan Brown at the Carnegie Endowment in Washington, has been "uncharacteristically multilateral in its approach thus far, consulting with allies and avoiding staking out a very strong position." An even greater sense of wait-and-see prevails among European donors, who remain divided over what level of aid is politically and legally acceptable.

How much does the PA stand to lose? Foreign aid, averaging $1 billion a year for the past five years, comes in three kinds: development aid (such as infrastructure projects), budget support, and humanitarian aid. Development aid will probably be cut, though a lot may well be rerouted—either by paying money directly to contractors, funnelling it through agencies like the World Bank that don't have the same political restrictions as the donor countries, or reclassifying it as humanitarian aid.

The budget will suffer more. Last year some $360m of the PA's $1.9 billion budget came from donors of all kinds, and around $700m from revenues collected by Israel. Humanitarian aid, both American and Israeli politicians have said, should be preserved as far as possible: the aim is to hurt Hamas, not the Palestinians. But $1 billion last year went on paying the PA's 137,000 employees, and their wages support a third or so of the population. The February pay packet was disbursed some ten days late; at the moment, nobody knows where the cash due on March 1st will come from.

A defiant Hamas says it will get it elsewhere. Arab governments, which have helped the PA out in the past, face a dilemma: ignore America's wishes or ignore the rising pressure for democratisation and the growth of Islamist political forces in their own countries. But even if they cave in to the Americans, Hamas has much more experience than Fatah in collecting money through informal networks, charitable donations and the like.

Hamas could also save a lot just by trimming the grossly bloated payroll. According to some reports it plans to

reduce the workforce to 100,000. That would be hard, not only because it means throwing thousands of people on to the streets in a struggling economy, but because Hamas will probably want to replace several thousand more Fatah loyalists in the security forces with its own men. But if it succeeds despite the loss of foreign cash, the result will be a PA that is leaner—and meaner.

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Nigeria

A spectre of turmoil and conflict

Feb 23rd 2006 | LAGOS
From The Economist print edition

Africa's oil giant is facing economic and political chaos on several fronts

Get article background

Reuters

Obasanjo ponders whether to stay on

THE country is in a crisis. Last week, insurgents in the oil-rich Niger Delta region kidnapped nine foreign workers and blew up oil facilities there, forcing the world's eighth largest oil exporter to cut its output by a fifth. This week, in the Muslim-dominated north, mobs went on the rampage, burning churches and killing dozens in the most violent demonstrations sparked so far by the Danish cartoons lampooning the Prophet Muhammad. And in the east, Christian mobs have retaliated by torching mosques, killing dozens of Muslims and forcing thousands to flee their homes. These outbreaks of chaos in Africa's most populous country, 130m-strong, are an ugly omen as Nigeria heads towards national elections next year, when Olusegun Obasanjo is due to step down after two terms as president.

The Movement for the Emancipation of the Niger Delta (MEND), which claims to have carried out the delta attacks, says it will fight on until the central government agrees to let states that produce the oil control its revenue. MEND says it has the support of the biggest tribe in the delta, the Ijaw, who feel cheated out of wealth pumped from their lands, both by the central government and by the oil companies. MEND has not yet revealed its backers—probably shady but influential politicians.

Though Mr Obasanjo has sought to reassure foreign diplomats, the violence presents him with a big security dilemma. As a civilian president elected after military rule ended in 1999, he has staked his international reputation on making Nigeria more stable and prosperous. But years of neglect have left the armed forces with only a few boats to patrol the delta's vast network of swamps and creeks. Militants have been able to attack at will. The situation is complicated by the many armed groups and security officials who form cartels to export stolen oil to international criminal syndicates.

Mr Obasanjo, a former military ruler, was selected by Nigeria's political elite to stand as a consensus candidate in elections after the death of Nigeria's last military dictator, Sani Abacha, in 1998. But Mr Obasanjo has annoyed many senior Nigerian politicians by his anti-corruption campaigns, which they see as politically motivated, and by his apparent breaking of promises. “He's isolated everybody who initially gave him goodwill,” said a retired but still politically active general.

Mr Obasanjo has been cracking down at any hint of secessionist dissent and has arrested a powerful Ijaw militant for alleged treason. His government has also irked Muslim leaders by banning special police used in one northern state to implement *sharia* law. Nigerian politicians have long been adept at using religion to stir things up. Thousands of people have been killed since 12 northern states (Nigeria has 36 in all) declared *sharia* law in 2000.

Muslim power-brokers expect the ruling People's Democratic Party to name a Muslim northerner to succeed Mr Obasanjo, a Christian southerner. But Mr Obasanjo refuses to dispel suspicion that he may try to force through a constitutional amendment to stay in office for a third term. His supporters, including some state governors who may also extend their terms in order to plunder state coffers, say Mr Obasanjo offers Nigeria its only chance of seriously reducing corruption.

Oil firms and western governments, including the Americans, are watching nervously. This month John Negroponte, the overall head of America's intelligence services, said that if Mr Obasanjo stayed on he might “unleash major turmoil and conflict” that could lead to a “disruption of oil supply, secessionist moves by regional governments, major refugee flows, and instability elsewhere in west Africa”. Mr Obasanjo likes to parade himself abroad as a peace-loving democrat and yearns to inherit the mantle of Africa's leading elder statesman, Nelson Mandela. If so, he should promise not to run again.

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Local democracy

A funny thing happened on the way to the council

Feb 23rd 2006
From The Economist print edition

Labour's big idea for resuscitating local democracy may kill the patient

BRITAIN'S town halls are rather inspiring places. Most were built in the 19th century in an imposing classical style. Their grand staircases are often lined with busts of Roman orators, while on the ceilings frescoed men do civic things in togas. Sadly, though, the councillors who inhabit them now hardly need to turn to the ancients. The government in Westminster allows them a little autonomy over planning, issuing alcohol licences, collecting rubbish and the design of lamp posts, but that's about it. Central government controls how much they tax and what they spend money on. As a result, voters pay them little attention: turnout in English local elections has slumped to around 35%.

So when David Miliband, the local government minister, gave a speech on February 21st that was billed as Labour's bid to revive local democracy, it caught the attention of people who fret about Britain's political health. Alan Milburn, health secretary until 2003, wrote a newspaper article this week in favour of decentralisation. And three other New Labour bellwethers—Liam Byrne, a junior minister and the only Labour MP with a Harvard MBA, James Purnell MP and Matthew Taylor, Tony Blair's chief policy wonk—published a pamphlet advocating varieties of localism. They called it “Power to the People”, and didn't even blush. Taken together, the outpourings have the feel of a Big Idea.

Mr Miliband thinks that while people are living longer, richer lives, the social networks that once nurtured them are vanishing. Yet government is remote and they feel powerless to influence things. His solution is “double devolution”: pushing more resources and responsibility for running things from central to local government (about which he provides no detail) and from town halls to an amorphous web of charities and voluntary associations. Citizens would be surveyed to determine how much happier they were. If they were not, then contracts with service providers would be torn up. The trouble with this prescription is that it is likely to make the problem that Mr Miliband has correctly identified even worse.

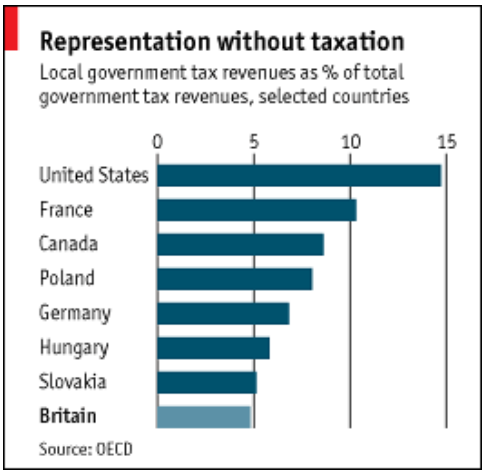
Power in Britain has long been more centralised than in America or other European countries, but it has become more so in the past 50 years. Building the welfare state after 1945 struck a big blow for centralisation, as the public services that absorbed the bulk of state spending were nationalised. Local government pottered on for a few more decades, declining in importance but not fully emasculated. That came in the 1980s, when Margaret Thatcher's Tory government applied a fiscal arm-lock to restrain loony left councils, capping the taxes they were allowed to charge. Following the failure of the poll tax, a regressive and deeply unpopular local levy, councils became even more dependent on central government for cash. Then, in 1990, their power to set levels of taxation on business was taken away too.

As a result, local government in Britain now raises—through property taxes—only a quarter of what it spends and only 5% of total government revenue, an unusually low level for a large, wealthy democracy (see chart). If councils try to raise more, the government steps in to prevent them.

Because government departments in London control the purse strings, they also like to keep track of how money is spent. That means even good councils are treated like naughty schoolchildren. Sir Sandy Bruce-Lockhart, who runs Conservative-held Kent County Council and also chairs the bipartisan Local Government Association, says his council has to provide the government with information on over a thousand performance indicators. Some of these measure sensible things, but many do not. Why, Sir Sandy asks, does Britain need national standards on swimming pools? If a council falls behind in one area (or simply tries something different), teams of inspectors from Whitehall descend. Eric Pickles, the Tory shadow minister for local government, describes the system as “Stalinism without the violence”.

Monitoring local government currently costs £2.5 billion ($4.4 billion) a year, and that does not include the cost to councils of being inspected. But the political burden of centralisation is onerous too. Members of Parliament increasingly complain that their mailbags are full of letters

about broken pavements and wheelie bins rather than affairs of state. Before he stepped down as a Labour MP last year, Tony Banks, who died last month, said this constituency work had become “intellectually numbing” and MPs little more than “high-powered social workers”. It is hardly surprising, that in a country which is so centralised, voters ignore their councillors and look instead to their representative in Westminster for redress.



That means MPs increasingly pass laws on local matters. Anti-social behaviour orders, created to deal with low-level misdemeanours, are a good example. Then once a new law is passed, the government tends to step in, sets targets and discourages local councils from experimenting with different ways of doing things.

“If Britain were a province of Russia,” says Tony Travers, of the London School of Economics, “the Department for International Development would be saying that it needed help with ‘capacity building' in local institutions.” This indeed seems to be the aim of the new thinking that will find its way into proposals for local government reform this summer. A better idea would be to give councils real control over how they tax and spend. Who knows, people might then bother to vote for them.

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Prince Charles and the press

The dissident prince

Feb 23rd 2006
From The Economist print edition

Where discretion is the better part of valour

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PRINCE CHARLES has had to endure more than his fair share of embarrassments. Mostly, they have made him seem either a bit of a twit (fantasising about being a tampon) or hopelessly spoilt and out of touch (having his valet put the toothpaste on his toothbrush each night). The heir to the throne's latest scrape is more serious.

The prince is currently suing the *Mail on Sunday* for having breached his confidentiality and copyright when it published extracts last November from a "journal" he wrote after the handover of Hong Kong to China in 1997. In it, the prince makes some gloomy forecasts about Hong Kong's likely fate and disparaging remarks about the colony's new masters, describing some Chinese officials as "appalling old waxworks".

The prince claims that the journal, circulated to a few close friends and relatives, was not for public consumption, and that he is entitled to the same privacy as the "humblest private citizen".

But by seeking legal redress, the prince has only made things worse. In its defence, the *Mail on Sunday* obtained a damaging ten-page statement from Mark Bolland, the prince's former public relations manager. Prince Charles failed this week in his attempt to ban its publication, and the rest of his Hong Kong journal was also shown to the press.

Mr Bolland, who feels badly treated by Buckingham Palace, describes how the prince saw himself as a "dissident" struggling against prevailing political orthodoxies. Despite warnings from his advisers, he fought a contentious battle against genetically modified foods. On another occasion he refused to attend a state banquet at the Chinese embassy because of his dislike for the regime, and then ensured that newspapers were briefed about the snub.

Prince Charles has a right to strongly-held views, especially where they are aesthetic or social; indeed, these are a welcome spur to public debate. But to use his position to seek to change opinion in political matters is in breach of his constitutional obligations and in contrast to his mother's punctiliousness.

The prince's latest campaign is to restore the neglected dish of mutton to the nation's tables. If he sticks to that kind of thing, there will be relief all round.

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Extraditing bankers

No place like home

Feb 23rd 2006
From The Economist print edition

A High Court ruling clears the way for extradition

BUSINESSMEN are quaking in their boots. The first high-profile white-collar challenge to Britain's controversial new fast-track extradition arrangements with the United States was decided on February 21st, and not the way many of them wanted. The High Court turned down an appeal by three former NatWest investment bankers against extradition to the United States, where they are wanted on fraud charges related to the Enron mess.

The Anglo-American extradition treaty has provoked anger and dismay since it was secretly negotiated in 2003, allegedly to make prosecuting terrorists easier. British critics say it is lopsided and unfair. America now has only to allege that an “extraditable” offence—one carrying a maximum prison sentence of at least one year—has been committed to justify a request for extradition, while Britain still has to submit supporting evidence.

The new regime denies the defendant a chance to challenge the evidence against him in an English court. It also removes the home secretary's discretion to block extradition if he feels it to be “wrong, unjust or oppressive”. Now he can do so only if the defendant might face the death penalty, or on purely technical grounds.

The biggest problem, however, is that legal proceedings are harsher in the United States than in Britain. With plea bargaining, defendants are under huge pressure to plead guilty. Sentences tend to be more severe. Defendants, even if acquitted, pay their own costs. And non-residents rarely get bail, so they may spend months or years behind bars awaiting trial.

The Home Office claims that the new treaty simply gives America a squarer deal than it used to get. Before, the United States had to provide prima facie evidence to justify extradition, a tougher burden of proof than Britain's “probable cause”. Appeals slowed things in Britain too. It used to take 30 months for America to extract a suspect from Britain, but only five months the other way round. The American process now takes a more equivalent six months.

This will be little consolation to the “NatWest three”—Gary Mulgrew, Giles Darby and David Bermingham—who face indictment in America on seven counts of wire fraud. They have been advised that they could face two years in a Texan prison preparing their case, legal costs of $1.5m (£860,000) each and, if convicted, up to 28 years in jail. They are accused of conspiring with former Enron executives in a fraudulent deal involving NatWest, from which they allegedly made nearly £1.5m apiece. They deny the charges.

Given that they are all British, most of the alleged misconduct occurred in Britain and the principal victim was British, the three men argued that they should have been prosecuted in Britain. Under the rule of double jeopardy, no one can be extradited for a crime for which he has already been tried. But, for reasons that remain unclear, the Serious Fraud Office declined to bring any proceedings against them. In its ruling, the High Court upheld the SFO's discretion to do so. It also dismissed an appeal on human-rights grounds. The men plan to appeal to the House of Lords, Britain's highest court.

Other white-collar extradition cases are pending, and business leaders are growing increasingly worried. The new regime could deter Britons from doing business in America, they say. More than 140 MPs have signed a motion calling for an amendment requiring America to provide prima facie evidence in extradition cases.

Forgotten in the transatlantic flurry, however, is the fact that Britain also has fast-track agreements with 47 other countries—signatories, for the most part, of a Council of Europe convention—which no longer need to furnish prima facie evidence in requesting extradition. Texan jails may be bad, but Turkish ones?

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New drugs

Inescapable trade-offs

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PA

All for one and one for all

Weighing up the costs as well as the benefits from new medicines is vital

OVER the past few months there has been a rumbling row about Herceptin, an expensive breast-cancer drug that patients are struggling to get through the publicly funded National Health Service for an aggressive form of early-stage breast cancer. The current position is a mess, with payment for the drug depending on where patients live, rekindling the charge that the NHS is a “postcode lottery”.

The controversy has highlighted the question of how costly new therapies are to be introduced into the NHS. This week, for example, doctors called on the government to ensure access to two new treatments for brain tumours. At the centre of such judgments is—or should be—the National Institute for Health and Clinical Excellence. NICE does not license drugs for their efficacy and safety, a job done by regulatory authorities like the European Medicines Agency (EMEA). Instead it provides guidance to the NHS on how clinically effective and cost-effective new drugs are.

The present muddle over Herceptin is, in a bitter irony, exactly what NICE was supposed to prevent when it was established in 1999. A principal objective was to avoid the postcode lottery, while another was to ensure faster access to new drugs that work. Crucially, NICE recommendations give the green light to funding. Once it has advised that a medicine represents good value for money, primary-care trusts (PCTs)—the 300 local NHS organisations that pay for most health care in England—are expected to finance the drug, if prescribed by doctors, within three months.

In the past seven years, NICE has issued 97 reports on new technologies, mainly drugs. To establish whether they are cost-effective, NICE works out how much health gain—measured as a “quality-adjusted life year” (QALY)—they achieve for the money spent. While there is no binding limit, NICE rarely accepts that drugs are cost-effective if they cost more than £25,000-35,000 per QALY, says Sir Michael Rawlins, its chairman.

“NICE has been pretty successful thus far,” says Nancy Devlin, a health economist at City University; it is doing a good job weighing up the evidence on new drugs in a systematic way. So what has gone wrong in the case of Herceptin?

The NHS is already paying for the drug to treat a form of advanced breast cancer, for which Herceptin was first licensed in Europe in 2000. After the release of promising clinical results in May 2005, patients campaigned to get it when the disease is still at an early stage. (This is when it is confined to the breast and the surrounding lymph nodes but has not spread elsewhere in the body, explains Karol Sikora, a cancer specialist.) But NICE could not provide any guidance because a precondition for one of its assessments is that the drug has been duly licensed. Not until February 16th did Roche, the firm marketing the drug outside America, apply to EMEA for an extension of its licence for Herceptin.

The hiatus may be understandable but not for patients desperate for state-of-the art medicines, whatever their

cost. Naturally, they have lobbied for Herceptin to be made available as soon as possible, even though it costs around £20,000 a year to treat one patient. The campaign paid off politically. Despite the lack of any guidance from NICE, Patricia Hewitt, the health secretary, said in October that PCTs should not refuse to fund Herceptin solely on the grounds of cost. That in turn has led some to finance the drug, while it remains unavailable in other parts of the country.

The good news is that this unhappy situation, which has led to charges of political interference, will be resolved later this year. Now that Roche has applied for a licence, which EMEA should deal with in two to three months, NICE expects to be able to issue guidance in August.

The new “fast-track” procedure under which NICE will consider Herceptin is a response to criticism that it takes too long to issue guidance on new drugs. At present, its appraisals take on average 14-15 months. One reason why the process is often protracted is that NICE usually has to compare more than one drug. When considering a single medicine like Herceptin, the evaluation can be much quicker.

But if NICE provides faster and generally favourable guidance on new drugs, that will intensify the financial pressure on the NHS. Julian Le Grand, a former health-policy adviser to Tony Blair, says that NICE evaluations do not consider their overall affordability: “They don't take into account what the new drug might displace”.

The row over Herceptin may be a foretaste of what is to come. With information about new drugs now disseminated so swiftly, the pressure from patients to get them quickly can only grow. That will make dispassionate decisions to ensure value for money even more important.

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Anglican investment

Holier than thou

Feb 23rd 2006
From The Economist print edition

The West Bank divides Britain's Anglicans and Jews

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IF THERE is one thing at which English churchmen have excelled, it is accommodating difference. Only a commission of Anglicans could have penned the Windsor report, for example: the document, replete with soothing messages for homophobes and gays alike, serves as the basis of the Anglican communion's efforts to stave off a schism over homosexuality. In the words of Jonathan Bartley, of the religious think-tank Ekklesia, “We follow Saint Paul's advice to be all things to all men.”

But occasionally, it seems, the habit of compromise reaches its limit. Relations between Anglicans and Jews were plunged into their nastiest crisis in a generation after the synod of the Church of England (an elected parliament of clergy and laity) passed a resolution on February 5th which had all the subtlety of a bulldozer.

The issue has been grinding its way through the decision-making mills of England's official church for several years: whether to show disapproval of Israel's tactics in the occupied West Bank by withdrawing investment from firms deemed to be profiting from them. Attention has focused on Caterpillar, an American company whose D-9 bulldozers have been used to demolish Palestinian homes—although the firm insists that the machines were sold to the American government, and it can't control their ultimate use.

Last September, an Ethical Investment Advisory Group—whose job is to offer moral guidelines for the church's £900m investment portfolio—advised against withdrawing the £2m Anglican stake in Caterpillar, on grounds that the company had apparently ceased to provide Israel (even indirectly) with bulldozers—and that the “fluid situation” in the Middle East made it a bad time for abrupt moves.

The synod, however, rejected such hand-wringing. It voted for a motion urging the church's money-minders to “disinvest from companies profiting from the illegal occupation, such as Caterpillar Inc, until they change their policies”.

Sir Jonathan Sacks, Britain's chief rabbi, lost his customary cool. He accused the Anglicans of meddling in things over which they had no control—like the Israeli-Palestinian conflict—while creating “the most adverse repercussions” for something they could influence, Christian-Jewish relations. Why, he and many Jews asked, did the motion fail to mention Iran's threats to destroy Israel, or the election victory of Hamas, which shares that aim?

Since then, fences have been mended in a British way. Rowan Williams, the Archbishop of Canterbury, voiced “deep regret” over the fact that “much distress has been caused, especially to our Jewish friends” by a resolution which, whatever else it said, did not question Israel's right to exist and defend itself, or condone violence against Israel. Sir Jonathan replied graciously, thanking the archbishop for his promise that the synod had stopped short of a formal decision to disinvest.

The net result, observes Jonathan Gorsky of the Council of Christians and Jews, is that British adherents of those two faiths are still on speaking terms—and will remain so as long as those who criticise Israel are careful not to endorse terrorism or anti-Semitism. That ought not to be impossible. It was the chief rabbi himself, after all, who said in 2002 that Israeli policy in the West Bank was incompatible with the deepest ideals of Judaism.

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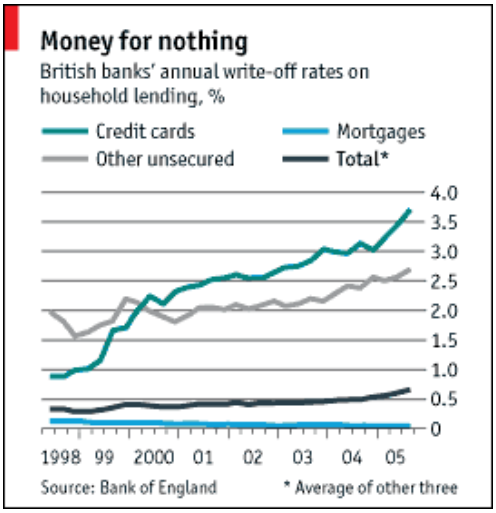
Banks and borrowing

Not waving but drowning

Feb 23rd 2006
From The Economist print edition

It's not too soon to worry about consumer debt



BRITAIN'S banks, born to empire, have seldom sailed such favourable winds. Most are likely to report record earnings for 2005, helped by expansion abroad, healthy corporate demand for loans and a resurgence in mortgage borrowing at home. And the outlook is good, too. Goldman Sachs, an investment bank, forecasts an 11% rise in after-tax earnings for 2006. But there are also some worrying signs of trouble ahead. Barclays, Britain's third-largest bank, said this week that its bad-debt provisions had jumped by 44% last year as more credit-card borrowers missed payments on ever-larger debts.

The increase should have been expected. Loan losses as a share of both personal and corporate lending have fallen sharply in recent years, as interest rates declined, house prices rose and Britain's economy chugged along, merrily creating jobs. They could not stay that low forever, and they have risen only slightly now. Though bad debts are ballooning on credit cards (see chart), mortgage arrears have fallen and repossessions remain low compared with the not-too-distant past. The 10,250 properties seized by banks last year were 70% higher than in 2004, but the figure pales next to the 75,540 repossessed in 1991, in the depths of the previous recession. And new legislation that makes it easier for people to declare themselves bankrupt and be rehabilitated is encouraging some to walk away from debts they would once have paid.

Yet the blossoming of bad debts at Barclays, which for the past two years has been turning down more than half the credit card applications it receives, will exacerbate concerns stoked by two recent reports. Personal bankruptcies and individual voluntary arrangements (a personal “chapter 11” giving protection from creditors) rose to a record 67,580 last year in England and Wales, the Office for National Statistics said this month. Credit card debts and other unsecured loans are responsible for much of the rise in defaults, but secured debts are also being affected. Meanwhile, the Bank of England estimates that in the nine months to September, banks wrote off about £3.6 billion on unsecured loans, more or less a fifth of their total profit from all activities. It also frets that the number of households facing financial difficulties has increased.

The Bank reckons that unsecured loan losses would have to rise “substantially” to threaten the financial stability of the nation's banks. But there are some disturbing signs that just such an increase may be in the making.

First, bad debts are increasing despite the absence of serious deterioration in the economy. Unemployment, although rising, remains fairly unthreatening, and interest rates are low. Yet the Financial Services Authority (FSA) estimates that some 2m families are “constantly struggling, but not currently in arrears” with their debts and that 15% of British adults have fallen behind by three months or more on their commitments in the past five years. The proportion of those in trouble may double in the next five, it reckons.

Unlike previous turns in the credit cycle, when sharp changes in external circumstances—such as getting fired—pushed people into arrears, now it seems that consumers are simply beginning to creak under the accumulated weight of their borrowing. About 5% of adults say they regularly spend more than they earn, according to a survey commissioned by Debt Free Direct, a company that provides insolvency advice.

A second concern is that many more are in trouble, even if not in actual default. Bank analysts at Credit Suisse, an investment bank, estimate that between 1m and 2m people are making only minimum payments on their consumer loans. At that pace, a £1,000 Barclaycard debt would take 25 years to get repaid, they calculate. No wonder that the average person applying for protection from creditors has unsecured debts of more than £37,000, owed to more than ten creditors. “We're just seeing the tip of the iceberg,” says Paul Latham, the finance director of Debt Free Direct. “There is a pool of people out there with no hope of ever paying off their debts.”

And thirdly, it wouldn't take much to push large numbers of borrowers over the edge. A survey by the FSA found

that while 62% of consumers say they have no difficulty covering their mortgages, that would fall to 55% if repayments rose by 10% (roughly a half-point increase in the benchmark interest rate, though there are no signs at present that rates are set to rise).

For now, bankers are playing down concerns. John Varley, Barclays' boss, says that “banks take risks and I expect banks to absorb bad debt.” It's a line he may get to polish over the next few years.

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Railways in play

Railpolitik

Feb 23rd 2006
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A controversial bid for London & Continental is raising eyebrows

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BIG transport deals are like buses: they may be rare, but when they do happen, several come at once. One week after Ferrovial, a Spanish construction firm, announced that it was considering buying BAA, Britain's airports operator, ministers announced a prospective bid for London & Continental Railways (LCR), the state-supported company building the £5.2 billion Channel Tunnel Rail Link (CTRL).

The suitor is Sir Adrian Montague, a City grandee, former government adviser and rail bigwig who is backed by Goldman Sachs, an American investment bank. The rail link is due to be finished early next year, and several of LCR's shareholders (a disparate bunch encompassing Bechtel, an American engineering firm, National Express, a bus operator, UBS, a Swiss investment bank, and several others) are believed to be keen to sell their stakes.

Rob Holden, LCR's boss, dismissed the bid as “opportunistic” and “a distraction”. He has unveiled his own plan for the separate sale of Eurostar UK (the train service that will run on the CTRL), the company's land holdings and the track itself after the link is finished. Any change of ownership before then, he warned, could lead to the link being delayed. That would embarrass the government. It has already had to rescue the company once, in 1998, guaranteeing £3.7 billion of its debt. It now has a “special share” that gives it effective control of the company, including the right to approve any sale.

The adviser on that rescue was a certain Sir Adrian Montague, who has counselled governments on everything from rail privatisation to private finance initiatives and later served as deputy chairman of Network Rail, the company that owns Britain's railway lines. His team thinks that squeezing efficiencies from LCR is more sensible than breaking it up. Part of LCR's attraction is its property portfolio, which includes a chunk of land in Stratford, close to the proposed route of Crossrail, a large and long-delayed railway scheme—formerly chaired by Sir Adrian—that will link east and west London.

Sir Adrian's closeness to the government has raised eyebrows. Alan Duncan, the Conservative shadow trade secretary, said the situation appeared “unsettlingly cosy”. The mutterings grew louder on February 20th, when the Office for National Statistics decided to re-classify LCR from a private to a public corporation. This has brought LCR's debt on to the government's balance sheet for the first time. Cynics claim that the government might nod through a quick sale to get it off again.

Sir Adrian's team rubbishes conspiracy theories, saying the deal is still at an early stage and the government's announcement of it was unhelpful. Transport officials insist that their goal in any sale would be to get the best deal possible for taxpayers. Revealing the bid now has given other investors time to come forward.

Still, worries persist. Chris Grayling, the Tory shadow transport secretary, has written to Alistair Darling, his opposite number in government, asking him to make public all the details of LCR's finances because “no one bidder should have access to what would be otherwise closed information.” But his plea seems to have fallen on deaf ears: “No information will be released that isn't already public,” says a transport spokesman.

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Bagehot

Worth leading

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There's a lot wrong with the Liberal Democrats, but they matter more than ever

IT WOULD be fair to say that the nation has contained its excitement while awaiting the outcome of the battle for the leadership of the Liberal Democrats, to be announced on March 2nd.

Unlike the Tory leadership election, which started slowly but reached a gripping climax, interest in the Lib Dems' contest rapidly faded after its tragi-comic beginning. The bungled ousting of the alcoholic Charles Kennedy, the tabloid exposure of one leadership candidate's dealings with male prostitutes and the attempt by another candidate to mislead about his own sexuality briefly got people's attention—but only as a crash prompts drivers on the other side of the road to slow down and rubberneck.

One reason for the general indifference is that the contest between the candidates has been flat. Simon Hughes, the party's president and the most left-wing of the three, never really got going after the revelation that he had hidden his sexual orientation for years. Sir Menzies “Ming” Campbell, the choice of the party's senior MPs and the early front-runner, set out to convey reassurance and steadiness but ended up looking staid and a bit dull.

What little excitement there has been owed more to the fact that Chris Huhne bid for the job of leader than to anything he has said. Mr Huhne showed daring in standing after only eight months as an MP. His professionally run campaign could run Sir Ming uncomfortably close. Though he is one of nature's policy wonks, he has shamelessly tickled the party's erogenous zones.

But the main reason that few seem to care who will lead the Lib Dems is that the media commentariat collectively decided that it didn't matter. The Lib Dems were a party on the slide, they seemed to believe, even before its recent self-inflicted wounds.

Though the Lib Dems increased their seats in the general election last May, the party had expected to do better and was left divided and uncertain about its future direction. Self-styled modernising MPs were tired of trying to defend intellectually incoherent policies too often dictated by short-term electoral opportunism, while left-leaning activists suspected them of a New Labour-style plot to hijack the party. Mr Kennedy's flagging attempts to appease both sides contributed as much to his removal as his weakness for the bottle.

In poor shape anyway, the party was vulnerable to the repositioning of the two big parties, many thought. David Cameron was determined to recast the Tories as decent, caring and, well, liberal; while Gordon Brown would surely lose no time in distancing himself from the more unpopular features of Tony Blair's premiership, above all Iraq. Squeezed by cuddly Conservatives on one side and a Labour government at least rhetorically more sensitive to its supporters' feelings on the other, the political space left to the Lib Dems would shrink.

There always seemed something slightly flawed in this clever-clogs analysis. The Dunfermline and West Fife by-election on February 9th was a timely reminder of what it was. A Labour government enjoying an unprecedented third term, grudgingly re-elected on only 35% of the votes cast and pursuing unprecedentedly right-of-centre policies, is also unprecedentedly exposed to attack from the centre-left.

The attempts to write the Lib Dems off as a leaderless laughing stock made not the slightest impression on the Dunfermline electorate. Bored with Labour and far from convinced that Mr Cameron's Tories had really changed, voters picked the Lib Dems as their default choice. This week, after a poor recent run of polls, ICM in the *Guardian* put the party back at 21%, within a point of its general election vote.

The idea that the Lib Dems would be left no electorally attractive space also made little sense. As Mr Blair's all-but-anointed successor, Mr Brown is now doing his utmost to portray himself as an ardent public service reformer who can also be relied upon always to put security before airy-fairy worries about civil liberties. He is at pains to suggest that his foreign policy would bear a striking similarity to Mr Blair's. Meanwhile, the growls from the Tory right are a warning to Mr Cameron that, though his party's head can see the sense of what he is trying to do, its heart is not really in it.

So there will be no shortage of opportunities for the Lib Dems to stake out positions that are both different and popular with a lot of people. The government's controversial schools bill is a case in point. When it is presented for its second reading in the House of Commons next month, both Labour (minus around 50 rebels) and Tory MPs will vote for it, however reluctantly. That will leave the field clear for the Lib Dems to claim that what matters to parents is improving standards in the classroom rather than structural upheaval and the false promise of choice. To many, this will sound like practical common sense.

Balancing act

But the biggest reason for taking the Lib Dems seriously is that they are very likely to hold the balance of power after the next election, as current spread-betting prices show. According to calculations in the 2005 British Election Study, an academic survey, a Tory lead of between one point and 11.8 points would leave no party with an overall majority. The width of that range—greater than in any previous election—is due to the fact that as many as one in seven MPs is now unattached to either Labour or the Conservatives and, as the BES points out, this figure is largely impervious to the relative popularity of the two main parties.

The leadership of a party that on many issues represents the main opposition, and which is highly likely to be in a strong position to decide who will form the next government, is not a trivial matter. The experienced judgment of Sir Ming has its attractions, but the gambler's streak that the competent and more sprightly Mr Huhne has revealed makes him the more interesting choice for a party badly in need of boldness.

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The business of giving

Feb 23rd 2006
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Philanthropy is flourishing as the number of super-rich people keeps growing. But the new donors are becoming much more businesslike about the way their money is used, says Matthew Bishop (interviewed here)

GIVING away money has never been so fashionable among the rich and famous. Bill Gates, today's pre-eminent philanthropist, has already handed over an unprecedented $31 billion to the Bill and Melinda Gates Foundation, mostly to tackle the health problems of the world's poor. Its generosity has earned the couple *Time* magazine's nomination as 2005's "people of the year", along with Bono, an activist rock star.

The next generation of technology leaders are already embracing the same ethos. Pierre Omidyar, the founder of eBay, and Jeff Skoll, the auction site's first chief executive, are each putting their billions to work to "make the world a better place". And when the founders of Google, Sergey Brin and Larry Page, took their company public, they announced that a slice of the search engine's equity and profits would go to Google.org, a philanthropic arm that they hope will one day "eclipse Google itself in overall world impact by ambitiously applying innovation and significant resources to the largest of the world's problems".

The new enthusiasm for philanthropy is in large part a consequence of the rapid wealth-creation of recent years, and of its uneven distribution. The world now boasts 691 billionaires, 388 of them "self-made", compared with 423 in 1996, according to *Forbes* magazine's "rich list" for 2005. Not all of these newly wealthy people are turning to philanthropy—and of those that do, many continue to give in unimaginative ways, say to support an institution such as their *alma mater*. But the extra wealth is creating huge new opportunities. "This is a historic moment in the evolution of philanthropy," says Katherine Fulton, co-author of a recent report on the industry, "Looking out for the Future". "If only 5-10% of the new billionaires are imaginative in their giving, they will transform philanthropy over the next 20 years."

For now, it does look as though everyone, from Michael Bloomberg, the billionaire mayor of New York, to hedge-fund tycoons and film stars, is opening their wallet for a good cause. In Manhattan these days, a table for ten at the best charitable fund-raising dinners can cost $1m. Celebrities are increasingly putting their own money into good works, as well as playing their time-honoured role of using their fame to raise money from others. The film star Angelina Jolie, for example, has backed up her public advocacy of the cause of refugees with substantial gifts to refugee organisations.

The media, which used to take little notice of charitable donations, now eagerly rank the super-rich by their munificence and berate those they regard as tight-fisted. The latest *Business Week* list, which ranks giving in the latest five years, is topped by Intel's co-founder, Gordon Moore, and his wife Betty, pushing Mr and Mrs Gates into second place. Among America's super-wealthy, it seems that only Warren Buffett, the world's second-richest man, still dedicates all his energies to making more money rather than giving away some of what he already has. But even he says it will all go to charity when he dies.

Nor is the fashion for giving limited to America, where philanthropists have long played a particularly prominent role. In Europe, too, entrepreneurs who have made a lot of money are starting to hand some of it to charitable causes. Examples include Britain's Dame Anita Roddick, founder of the Body Shop, and Arpad Busson, a colourful French hedge-fund boss. India's new wealthy, such as Azim Premji and Nandan Nilekani, two Bangalore technology-firm bosses, are also becoming keen philanthropists; and even the new rich of China and Russia are catching the bug. Roman Abramovich, a Russian oiligarch who became famous for buying Chelsea Football Club, has given away many millions to improve living conditions in the Kamchatka region of Russia. And so the list goes on.

The whys and wherefores

Why are they doing it? Many people are wary of rich folk bearing gifts, suspecting them of having hidden business or political motives, or feeling guilty about how they have made their pile, or simply enjoying an ego trip fuelled by generous tax breaks. But there could also be plenty of innocent and admirable reasons why the rich have become so much more open-handed. Never mind the motives: the important thing is to ensure that this largesse is put to good use.

Done well, philanthropy can have a hugely beneficial effect—witness the achievements of past giants such as Andrew Carnegie, John D. Rockefeller, Joseph Rowntree and William Wilberforce. This survey will argue that if the new generation of philanthropists get it right, they too can make a real difference to the world. But for that to happen, philanthropy will have to shed the amateurism that still pervades much of it and become a modern, efficient, global industry.

For much of the past half-century, America seemed exceptional in its enthusiasm for philanthropy. Claire Gaudiani, in her book, “The Greater Good: How Philanthropy Drives the American Economy and Can Save Capitalism”, makes a distinction between charity, which is about easing symptoms of distress, and philanthropy, which is about investing in solutions to the underlying problems. The “investment approach distinguishes the most significant kind of American generosity from the ‘poorhouse and soup line’ method and expresses our values of freedom, the individual, and entrepreneurialism,” she says. In practice, though, the borderline between the two is often blurred.

Over the years, many wealthy Americans have broadly followed the blueprint laid out by Andrew Carnegie in his 1889 essay, “Wealth”. The steel tycoon believed that growing inequality was the inescapable price of the wealth-creation that made social progress possible. To prevent this inequality undoing the “ties of brotherhood” that “bind together the rich and poor in harmonious relationship”, he argued that the wealthy had a duty to devote their fortunes to philanthropy. Not to do so was the worst sort of personal failure: “The man who dies thus rich dies disgraced.”

As a result, a far higher proportion of hospitals, libraries, universities and welfare services in America is funded by private donations than in other rich countries, where governments are spending proportionately more yet are still struggling to meet growing public expectations. Still, the differences can be exaggerated. America's basic health research is largely funded by the government, whereas in Britain much of it is paid for by the Wellcome Trust, a charitable foundation based in London, albeit set up by an American.

Britain's government has recently been trying to foster the philanthropic spirit, and other European countries are starting to follow suit. Even in China, the government seems keen to build up a non-profit sector that caters to social needs, and appears to be relaxing some of its rules to allow philanthropy to play a bigger role. The exception is Russia, where President Vladimir Putin, averse to concentrations of power outside his government, has cracked down on non-governmental organisations (NGOs) and their backers. Mikhail Khodorkovsky, the former boss of Yukos, a big oil company, was reportedly Russia's leading philanthropist before he was jailed after a show trial.

But just as the world's wealthy and powerful are discovering the joys of giving, students of the American model of philanthropy are becoming increasingly critical of its flaws. This is not just a private concern for the donors: because of America's huge tax breaks for charitable donations, it is a matter for public scrutiny too. The cover story of a recent issue of Stanford University's *Social Innovation Review* is entitled “A Failure of Philanthropy”. It argues that those American tax breaks are of most benefit to things like elite schools, concert halls and religious groups. “We should stop kidding ourselves that charity and philanthropy do much to help the poor,” says the author, Rob Reich.

A series of scandals at charitable foundations—mostly over excessive pay, jobs for family members and other extravagances—has attracted the ire of Congress, which is threatening tough new legislation. State attorneys-general are taking a greater interest, too.

Mainstream charities that rely largely on donations from the general public have also come under fire. The American Red Cross was exposed for diverting money raised for the families of victims of the September 11th 2001 terrorist attacks to other purposes. And after the Asian tsunami and Hurricane Katrina, two fund-raising former presidents, Bill Clinton and George Bush senior, found themselves having to reassure the public that they would monitor how the money was used.

One of the many things exposed by the collapse of Enron was that corporate philanthropy is often pretty sleazy too. A firm's executives can ingratiate themselves with business partners, and even with their own board members, by supporting their pet causes with funds from the company's charitable foundation, without breaking the law.

Wasting a fortune

But the problem lies far deeper. “Foundation scandals tend to be about pay and perks, but the real scandal is how much money is pissed away on activities that have no impact. Billions are wasted on ineffective philanthropy,” says Michael Porter, a management guru at the Harvard Business School. “Philanthropy is decades behind business in applying rigorous thinking to the use of money.” Mr Porter believes that the world of giving can be transformed by learning from the world of business. Many of the leaders of the new generation of philanthropists agree with him, so “there is a big opportunity over the next 20 years to figure out how to make philanthropy effective.”

Many of the new philanthropists are well aware that traditional philanthropy is not sufficiently businesslike. They want to bring about a productivity revolution in the industry by applying the best elements of the for-profit business world they know. That has prompted the industry to adopt (and adapt) some of the jargon familiar from the world of business. Philanthropists now talk about “social investing”, “venture philanthropy”, “social entrepreneurship” and the “triple bottom line”. The new approach to philanthropy is “strategic”, “market-conscious”, “knowledge-based” and often “high-engagement”, and always involves maximising the “leverage” of the donor's money.

Leverage is particularly important to the new philanthropists. They know that however large their personal fortunes, they are dwarfed by the financial resources at the disposal of governments and in the for-profit marketplace. So to make a real difference, they need to concentrate their resources on problems that are not being dealt with by governments or for-profit organisations. Being constrained by neither voters nor shareholders, they can take risks to find pioneering new solutions that can then be adopted on a larger scale by governments or for-profit firms.

But not everyone is convinced that philanthropists must become more business-minded. “We must reject the idea—well-intentioned, but dead wrong—that the primary path to greatness in the social sectors is to become ‘more like a business’,” wrote Jim Collins, a bestselling management author, in a recent monograph, “Good to Great and the Social Sectors”. His reason is disarmingly simple: “Most businesses are mediocre.”

Still, even Mr Collins agrees that the way in which money passes from philanthropists to the organisations that put it to work leaves much to be desired. Here there is some reason for hope. In recent years, a host of new firms and institutions have been created that, with luck and good management, will provide the infrastructure and intermediaries of a philanthropic capital market, an efficient way for philanthropists to get their money to those “social entrepreneurs” and others who need it. These newcomers include management consultants, research firms and a philanthropic investment bank of sorts.

Plenty can still go wrong. There is no market discipline to force philanthropists to adopt innovations, however desirable. And the new philanthropists, along with the innovators who are trying to help them become more efficient, may find the going harder than expected. “The new rich have often made their money very fast, and get intoxicated with their own brilliance into thinking they can quickly achieve results in the non-profit sector. They forget that their success may have been due to luck, and that the non-profit sector may be far more complex than where they have come from,” says Mario Morino of Venture Philanthropy Partners, one of America's leading venture philanthropists.

One obvious risk is of a political reaction against the philanthropic rich. The new philanthropists are not just into spending money. According to Greg Dees of Duke University, today's philanthropy is best defined as “mobilising and deploying private resources, including money, time, social capital and expertise, to improve the world in which we live.”

Peggy Rockefeller Dulany, who runs the Global Philanthropists Circle, makes a similar point. “With wealth comes education, decision-making power, links to elites in other countries and enormous convening power,” she says. “We are helping philanthropists to make use of all these advantages. It is using money and connections—whether personal, family or business—to create public benefit.”

A global elite, seeking to change the world by combining lots of money with new ideas, cutting-edge business techniques, media and marketing savvy, the mobilisation of citizens and helpful political connections: all this is

bound to set alarm bells ringing in some quarters even as it spreads hope in others. Already George Soros, a famous hedge-fund philanthropist, has become embroiled in controversy over the role of some of the organisations he funds in various former communist countries as well as in America itself. And last year Bob Geldof, Bono's philanthropist partner in rock activism, provoked demonstrations in Uganda when he suggested that the country's president should not stand for re-election. Philanthropy seems sure to become an increasingly hot political potato.

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To have, not to hold

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The rise of the new philanthropist

BILL GATES is much the most generous philanthropist since records began. The $31 billion he has donated so far is already many times the $6 billion (in 2005 dollars) given away by a previous giant of American philanthropy, John D. Rockefeller. And Microsoft's founder is only just getting started. By the end of his life, he intends to have handed over most of the rest of his fortune—put at $46.5 billion in *Forbes* magazine's latest "rich list"—to the Bill and Melinda Gates Foundation.

Mr Gates is given much of the credit for the rise in giving among today's super-rich. He seems to have discovered his generous streak relatively recently: in 1998, *The Economist* was still criticising him for sitting on his fortune. But since then "Bill Gates has made philanthropy the norm" among the super-rich of the world, says Vartan Gregorian, who runs the charitable foundation set up by Carnegie. "Giving is now what you are expected to do."

The power of Mr Gates's example is one reason why Mr Gregorian—who is a mentor to many of the new philanthropists around the world—is no fan of the secretive approach to giving. "I like people to be public about their philanthropy; it makes it more competitive if we can see who is doing what."

In order to give money away, you first have to have it. The past two decades have seen vast global wealth-creation, but the "winner-takes-all" aspect of many of today's fastest-growing markets, and the sharp reductions in top marginal income-tax rates and profit and capital taxes almost everywhere, have caused a rapid increase in inequality between the very rich and the rest. The number of billionaires is growing fast, and not just in America: of the 691 billionaires listed by *Forbes*, 350 live outside America, with Lakshmi Mittal, an Anglo-Indian steel tycoon, coming third overall. According to the latest annual survey by Cap Gemini and Merrill Lynch, the number of families with over $30m in investable assets has also risen rapidly, to 77,500, as has that of millionaires (defined as people with investable assets of at least $1m, not including their main home), now 8.3m worldwide against 7m in 1997.

In the technology industry, there are now several generations of newly wealthy people who are actively giving—the Hewlett and Packard families, Intel's Mr Moore, Mr Gates, eBay's Messrs Omidyar and Skoll and the newest billionaires on the block, Google's Messrs Page and Brin. Likewise, in the financial industry newly super-rich hedge-fund stars are following in the philanthropic footsteps of Mr Soros. Performance-based donations to charity are now sometimes built into a hedge fund's structure. For example, one-third of all the fees earned by the Children's Investment Fund, one of Europe's leading hedge funds, goes to a foundation that helps children in the developing world.

In Europe, following in America's footsteps, the gradual emergence of an equity culture has generated serious wealth for owners selling their business in an initial public offering. A fair amount of this money is going into charitable foundations. In Germany, for instance, their number has increased from 4,000 in 1997 to over 13,000 now. Germany's best-known charitable foundation, Bertelsmann, which is now mentoring some

of these newcomers, says that half the founders are actively involved in their foundations, which for many have become a second career. In America, the number of private charitable foundations has soared from about 22,000 in the early 1980s to over 65,000 today, according to the Centre on Philanthropy at Indiana University.

In India, where traditional charitable giving within communities has dwindled because of urbanisation, those newly enriched by the country's technology boom are starting to fill the void. The wealthy bosses of Infosys, Wipro and Dr Reddy are becoming big philanthropists, joining more established Indian business philanthropists such as the Tata, Birla and Bajas families.

In Latin America and Asia, "whoever has got wealthy...has now got an agenda to give," says Martin Liechti of UBS, a Swiss bank. He points out that a generational shift is under way from the old wealthy, who tended to practise traditional charity, to the new wealthy, who are open to more entrepreneurial approaches.

Although in many countries the poor give away a higher proportion of their total income than do the rich, it is the wealthy who dominate charitable giving. In America, for instance, families with a net worth of $1m or more accounted for 4.9% of the total number of all donations to charitable organisations in 1997, but as much as 42% of the value, according to a study by Paul Schervish of Boston College. The concentration in bequests is also striking: estates worth $20m or more made up 0.4% of their total number but 58% of their value.

In most countries, total giving has been rising slowly, although the outpouring of public sympathy after a series of natural disasters made 2005 a bumper year for donations. Surveys show that in many countries the public's trust in charitable organisations is falling, and there are growing worries that donations will not be put to good use.

According to an annual survey, Giving USA, total charitable giving in America in 2004 rose by 5% to a record $249 billion, over 2% of GDP. That was more than in any other big country, both in absolute terms and as a proportion of GDP. And even if you ignore donations to religious congregations and add in the value of volunteering, America is still a global leader in giving. A study led by Lester Salamon of Johns Hopkins University of charitable giving in 36 countries, excluding donations to religious congregations, showed that in the seven years to 2002 such giving in developed countries ranged from around 1.85% of GDP in America to 0.11% in Italy.

Generosity writ large 2

America's top 20 philanthropists

	Background	Amount, $bn*
Gordon & Betty Moore	Intel co-founder	7.05
Bill & Melinda Gates	Microsoft co-founder	5.46
Warren Buffett	Berkshire Hathaway CEO	2.62†
George Soros	Investor	2.37
Eli & Edythe Broad	SunAmerica, KB Home founder	1.48
James & Virginia Stowers	American Century founder	1.21
Walton family	Family of Wal-Mart founder	1.10
Alfred Mann	Medical devices	0.99
Michael & Susan Dell	Dell founder	0.93
George Kaiser	Oil & gas, banking, real estate	0.62
John Templeton	Investor	0.56
Ruth Lilly	Eli Lilly heiress	0.56
Michael Bloomberg	Bloomberg founder, NYC mayor	0.53
Veronica Atkins	Widow of Robert Atkins	0.50
Jeff Skoll	Founding president of eBay	0.49
Ted Turner	CNN founder	0.46
Kirk Kerkorian	Investor	0.45
Donald Bren	Real estate	0.45
Pierre & Pam Omidyar	EBay chairman, founder	0.43
Patrick & Lore Harp McGovern	IDG founder	0.37

*Given or pledged during 2001-05 †Includes a $2.5bn bequest by his deceased wife Susan Buffett

Source: *Business Week*

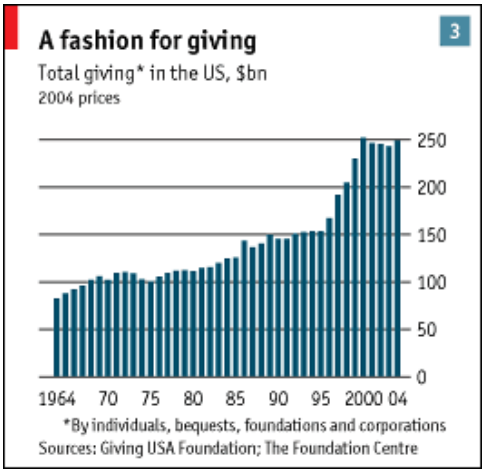
Mr Salamon also notes that measured against state spending on welfare, charitable spending is tiny everywhere. In America, such welfare spending equals 18% of GDP; in Britain, 28%. This shows just how hard it will be for the new philanthropists to ensure that their money makes a real impact, especially in rich countries.

According to an adviser to a leading Swiss private bank, around one-quarter of its super-rich clients are already committed to philanthropy. A further 40% are actively thinking about it, and another 15% are just starting to put it on their agenda. What motivates them?

Religion has always played a big part in giving (Christians, Jews, Muslims and Sikhs all traditionally aim to give away a set proportion of their income). In America, religious giving accounts for a staggering 62% of total donations, according to Indiana University's Centre on Philanthropy Panel Study, and donations to religious causes outweigh those to non-religious ones in every income group. In Europe, religious giving is generally lower. In Britain, a recent study by the Charities Aid Foundation, a non-profit body, found that faith-based organisations accounted for 10% of the 500 largest charities' income. Among the super-rich of the Muslim world, the Islamic prohibition of things such as alcohol, pork, gambling and conventional financial services has opened up a role for philanthropy: those whose portfolios include such activities can "purify" them by giving the resulting profits away.

"The rich are trying to figure out a moral biography of wealth, and philanthropy can provide part of the purpose side of living the good life," even if you are not religious, reckons Mr Schervish. Becoming very rich can rob you of your old ambitions and give you a need for new ones. Why did Sir Tom Hunter, a Scottish retail entrepreneur, become a philanthropist? "Aged 37, I got a massive cheque. I had achieved all my goals at that time. So I started to think, what shall I do now?"

“There is a search for a narrative, about making a difference with your life, which is vaguely religious and gives you a buzz,” says Charles Handy, a management guru who is putting the finishing touches to a book about philanthropy in Britain, “Beyond Success: The New Philanthropists”. Mr Handy points to Abraham Maslow's hierarchy of needs, and suggests that nowadays more people are getting to the stage Maslow described as “the highest need, for a purpose beyond ourselves. They want to make a difference—it used to happen in their 60s and 70s, now it is in their 30s and 40s.”



Faced with the world's many and urgent problems, a lot of wealthy people are asking themselves: if I can help, why not? Mr Gates read a World Bank *World Development Report* and realised he could do something to improve public health in the world's poorest countries. That made it seem absurd to leave his philanthropy until old age, as he had previously intended.

A lot of giving is stimulated by personal experience. Wealthy people often want to show gratitude for something that helped them succeed, such as a school or a supportive community. Similarly, they may want to support a life-saving hospital or play a part in finding a cure for a disease that has afflicted someone close to them, or help a poor country they have visited. Indeed, newly wealthy Americans often give to causes abroad, says Mary Duke of HSBC, a bank. Promoting education and fighting disease and poverty in Africa are now high priorities. The Middle East too is rising up the agenda, in hopes of improving America's battered image in much of the region. So-called “diaspora philanthropy”—where people from, say, Mexico or India who have prospered abroad, send gifts home—is also increasingly popular.

Many rich people feel that they have been fortunate and want to “give something back”. But eBay's founder, Mr Omidyar, dislikes the phrase. “The classic business executive reaches his late 40s and says I want to give back. But what does that mean he has been doing? Taking away? What a sorry way to think about your career,” he says. It is hard to tell whether some of the new wealthy feel guilty, but certainly many of them think, like Carnegie, that philanthropy is part of a social contract: both a duty and an insurance policy against populist redistribution.

Social norms and peer pressure clearly play a part. The fund-raising events in London laid on by Mr Busson for his charitable foundation, Absolute Return for Kids (ARK), seem to be prising open the wallets of many people in hedge funds who would not have contributed otherwise. And not everybody's motives are lofty: Ms Fulton, the co-author of a new report on philanthropy, argues that “a lot of philanthropy is motivated by pleasure—ego gratification and reputation enhancement.”

Good examples can help to stimulate largesse. In Britain, the Beacon Prize, launched in 2003 to celebrate philanthropists, was an attempt to reverse a long stagnation in giving. There are signs that, slowly, British culture may be changing. “There is a mood now in Britain that there are niches that the government doesn't fill, and that if you have talent, money and time you should get into these gaps. Thirty years ago, a businessman would have said, ‘I pay my taxes, the government should do it’,” says Mr Handy, the management guru. “It is getting like America—if you are wealthy, you want to be on the giving list as well as the rich list.”

In continental Europe, a tradition of giving anonymously (not least to avoid the taxman's attention) has meant there is less peer pressure to give, and few role models for would-be new philanthropists. To help change that, Ise Bosch, a member of the family behind the eponymous electronics company, is now writing a “how-to” book on philanthropy. She has also formed a network called Pecunia for wealthy German women interested in giving.

Transcendental meditation

Many baby-boomers, with their children through college, their houses paid for and plenty of money tucked away for retirement, are now beginning to think about their legacy, which often involves philanthropy. “In an age where everything is up for sale, transcendence can be bought through philanthropic giving,” argued a working paper, “Strategic Legacy Creation: Toward a Novel Private Banking Proposition”, published by the University of St Gallen, Switzerland, in 2004. “While a bank cannot make people literally immortal, it can...create legacies for its clients that satisfy their need for transcendence,” according to the author, Maximilian Martin, now a philanthropy adviser at UBS.

Certainly, people tend to become more generous as they grow richer, both in life and in death. Mr Schervish points out that between 1992 and 1997 the value of final estates in America rose by 65%, but charitable bequests went up by 110%. For the largest estates, the shift was even greater. One possible explanation is the growing concern of wealthy parents that if they leave too much to their kids, they will give them a nasty dose of “affluenza”, also known as “trust-fund baby syndrome”. “A

lot of people say they are not going to pass on much of their wealth to their kids, for fear of spoiling them," says Joe Toce of HSBC. "But as they get older, and grandchildren come along, they often end up passing on a lot to their descendants."

Nevertheless, when the baby-boom generation dies, vast amounts of money will be passed on, and a large chunk of that seems destined for philanthropic purposes—not least because involving children and grandchildren in the running of a foundation is increasingly seen as a way to give them a sense of purpose and to pass on family values.

International benefactors 4

The largest foundations in America and Europe

	Assets, $bn*
Bill & Melinda Gates Foundation *(US)*	28.80
The Wellcome Trust *(Britain)*	18.82
The Ford Foundation *(US)*	10.69
J. Paul Getty Trust *(US)*	9.64
The Robert Wood Johnson Foundation *(US)*	8.98
Lilly Endowment *(US)*	8.59
Fondazione Cariplo *(Italy)*	8.27
Fondazione Monte dei Paschi di Siena *(Italy)*	7.13
W.K. Kellogg Foundation *(US)*	6.80
The William & Flora Hewlett Foundation *(US)*	6.49

*Financial years ending 2004

Sources: The Foundation Centre; foundation reports

Self-interest

A secondary motive may be the desire to take advantage of the many tax incentives and other fixes that can make a wealthy person look virtuous at an appealingly low cost. America has the most generous treatment of charitable giving, allowing taxpayers to deduct their donations from their taxable income.

In Britain, too, the tax system has become much more philanthropy-friendly. Other parts of Europe are following slowly. The European Foundation Centre is lobbying for better tax treatment throughout the European Union. A particular concern is the harsh tax regime that some countries apply to giving abroad.

The recent tax reforms in Britain have not changed the tendency to give out of income rather than assets, in sharp contrast to the Americans, says Les Hems of the Institute for Philanthropy in London. There is currently no British version of America's popular "charitable remainder trust"—a device that allows a donor, say, to give away his house, claim an immediate tax break and then continue to live in it until his death, when the remaining value of the asset goes to the designated charity.

One of the strongest trends in American philanthropy in recent years has been the rapid growth of donor-advised funds, offered by money management companies such as Fidelity, whose fund is now America's fifth-biggest charity. These funds allow individuals to commit themselves to a donation and claim their tax deduction, but defer nominating a beneficiary and actually paying out the money until a later date. This has led Congress to suspect foul play—though not by Fidelity, which has a decent average pay-out rate of 25% of donated money each year.

Would scrapping inheritance tax, as President George Bush wants to do, hit charitable giving in America by removing one of the main penalties for not giving? Judging by how vigorously charities have been lobbying against the move, they clearly fear that they would lose out. But John Whitehead, a former boss of Goldman Sachs and now the *eminence grise* of New York philanthropy, believes that even if giving carried fewer tax advantages, it would not fall by as much as people fear, for "most of it is from the heart, not the pocketbook."

At any rate, many people reckon that philanthropists' motives are beside the point. As Mr Gregorian of the Carnegie Corporation says, "Why they give is not important; the act of giving, and how effectively they give, is what matters."

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The birth of philanthrocapitalism

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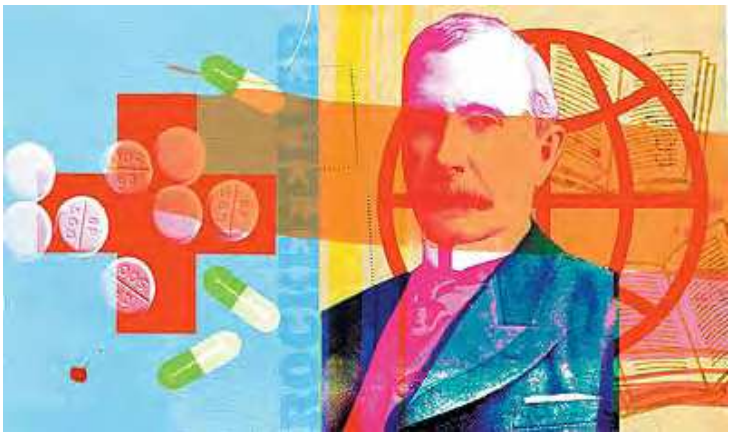

The leading new philanthropists see themselves as social investors

"RELATIVE to the corporate environment, we are in the 1870s. But philanthropy will increasingly come to resemble the capitalist economy," predicts Uday Khemka, a young Indian philanthropist and a director of the SUN Group investment company owned by his family. Like many of the new generation of philanthropists, he has big but well-defined ambitions. "I want to help develop the infrastructure of philanthropy," he says.

The need for philanthropy to become more like the for-profit capital markets is a common theme among the new philanthropists, especially those who have made their fortune in finance. As they see it, three things are needed for such a philanthropic marketplace to work.

First, there must be something for philanthropists to "invest" in—something that, ideally, will be created by "social entrepreneurs", just as in the for-profit world entrepreneurs create companies that end up traded on the stockmarket.

Second, the market requires an infrastructure, the philanthropic equivalent of stockmarkets, investment banks, research houses, management consultants and so on. This is what Mr Khemka wants to concentrate on.

Third, philanthropists themselves need to behave more like investors. That means allocating their money to make the greatest possible difference to society's problems: in other words, to maximise their "social return". Some might operate as relatively hands-off, diversified "social investors" and some as hands-on, engaged "venture philanthropists", the counterparts of mainstream venture capitalists.

All this may sound fine in theory. However, the history of philanthropy suggests that there are many potential pitfalls.

America's early charitable foundations were built by entrepreneurs. Carnegie and Rockefeller would have understood the new investment-oriented model. "Having seen their own economic activity transform the world, they thought that the foundations they left behind would be transformative organisations," says Carl Schramm, head of the Ewing Marion Kauffman Foundation. Those foundations did remarkable things. Set up as conduits for making grants as well as running the programmes that would benefit from the money, they thought big, concentrated on clear goals and were willing to invest heavily for long periods to achieve them, says Mr Schramm. The Rockefeller Foundation, for example, found a cure for yellow fever and drove the "green revolution" in agriculture. Carnegie, among other things, built thousands of public libraries.

Yet this long-term investment ethos has proved to be the exception, not the rule. In a landmark article, "Philanthropy's New Agenda: Creating Value", published in the *Harvard Business Review* in 1999, Michael Porter and Mark Kramer described widespread flaws in America's foundations that mostly remain to this day. For instance, little effort is devoted to measuring results, and foundations have unjustifiably high administration costs.

Michael Bailin, head of the Edna McConnell Clark Foundation, has described the typical foundation as "autocratic,

ineffective and wilful, elitist, cloistered, arrogant and pampered". There are "chronic problems in the way foundations operate", says Joel Fleischman, former head of the unusually impressive Atlantic Philanthropies, who is writing a book on the successes and failures of foundations. He says that most of them provide little information about what they do, and are particularly secretive about their failures. As a result, says Mr Fleischman, "foundations keep reinventing the wheel."

As for foundation governance, it is a nightmare, says Robert Monks, a veteran campaigner for better corporate governance: "Perpetual existence, no need to conform to competitive standards, it is all too much for human nature. Hence the palatial offices, fancy conferences and increasingly lavish pay for the professional philanthrocrats."

Arguably the biggest problem is the way that foundations make grants to organisations they support. Whereas Carnegie was willing to invest for the long term, more recently foundations have tended to chop and change, says Mr Fleischman. Melissa Berman of Rockefeller Philanthropy Advisors argues that there is too much emphasis on funding individual programmes and too little on the sustainability of the non-profit organisation running the programme. Overheads are seen as a bad thing, and grants tend to be short-term.

Should the new generation of philanthropists try something different from the traditional foundation? Ebay's Mr Omidyar thinks so. He has folded his Omidyar Foundation into Omidyar Network, which is free to make for-profit investments as well as philanthropic donations to pursue its mission of "individual self-empowerment". "After a few years trying to be a traditional philanthropist, I asked myself, if you are doing good, trying to make the world a better place, why limit yourself to non-profit?" he explains. Although there is a separate chequebook for the foundation, his "investment team" is free to put his money in either for-profit or non-profit projects. The team's main criterion is whether the investment will further the social mission.

Similarly, the Google Foundation is part of Google.org, which can mix for-profit and non-profit investments. However, unlike Omidyar Network, Google.org is an arm of Google, so this is corporate philanthropy—which raises a further series of difficult questions (see article).

In principle, large foundations should be the most effective vehicle for philanthropy, argue Messrs Porter and Kramer. Not only are they free from both political and commercial pressures, they also employ professional staff that smaller outfits would not be able to afford. But the staff often become the biggest problem, especially in foundations whose founder has long been dead.

The new philanthropists are mostly young enough to be able to keep an eye on their foundations for many years to come. Nonetheless, says Mr Fleischman, they might consider setting a closing date for their foundation. For instance, the John M. Olin Foundation, a big source of finance for conservative organisations, recently shut itself down. As John Miller recounts in his new book, "A Gift of Freedom", Olin had stipulated that all of his legacy should be spent within a generation of his death, a sunset model that kept it nimble, unbureaucratic and true to its founder's ideas.

The new philanthropists also need to be clear what they want to do, and stick with it. That is one lesson from the Gates Foundation, which has already notched up some remarkable achievements—helped by its huge size, which allows it to do things that are beyond everyone else. Its clear mission is to tackle global health inequalities in six main areas: infectious disease, HIV/AIDS, tuberculosis, reproductive health, global health strategies and global health technologies.

Leverage is all

Crucially, it has found ways of using its money to the greatest effect. Mr Gates's big idea is to overcome the market failure afflicting poor consumers of health care by deploying his money on behalf of the poor to generate the supply of drugs and treatments they need. For instance, the money provides market incentives for drug companies to put some of their resources to work for the needy.

The Gates Foundation also favours partnerships, even though it is big enough to pursue many projects on its own. Again, it is looking for maximum effectiveness. Other philanthropists are following similar strategies. For instance, Britain's Dame Stephanie Shirley wanted to fund research into an autism gene, the total cost of which she reckoned would be £1 billion ($1.7 billion). She stumped up £50m herself and is raising similar sums from other donors around the world. Another "hot" idea at the moment, championed by the X-Prize Foundation, is to donate large cash prizes that will generate lots of further spending from those competing to win them.

Mr Omidyar recently donated $100m to Tufts University to invest profitably in providers of microfinance to the poor. He hopes to attract private capital to turn what has largely been a subsidised business into a profitable one, operating on a far bigger scale than today.

Other new philanthropists are piloting new models for welfare provision that, once they have proved themselves,

can be taken up by governments and made available much more widely. Governments tend to be risk-averse, whereas philanthropists are free to take whatever risks they like with their money, so they can play a useful role as providers of start-up risk capital for government services.

Networks, too, are an increasingly popular way of leveraging money and experience. Peggy Rockefeller Dulany's Global Philanthropists Circle brings together about 50 super-rich families from 20 countries to exchange ideas and experiences, mainly with a view to finding solutions to international poverty and inequality. Often this will involve the use of connections and influence as well as money.

However, there is still a lack of global giving consortiums that take on single issues, says Mr Khemka. He hopes to bring together philanthropists from around the world who want to tackle climate change.

Some foundations are now exploring new ways of funding organisations. Mr Salamon of Johns Hopkins University thinks that they should start to behave more like philanthropic banks, offering a range of financial products such as loans and loan guarantees as well as grants.

Some philanthropists are also beginning to think about how best to harness all their assets to the causes they support, rather than just concentrating on the money they are currently giving away. This point was brought home recently to Jeff Skoll, one of whose philanthropic missions is to make films with a social message. His latest film is based on the book “Fast-Food Nation”—yet he had not checked his investment portfolio to see if he owned shares in food companies such as McDonald's that are attacked in the film.

Over the past year or so, many of the super-rich have started to ask themselves what exactly their assets are doing, says D.K. Matai, an Indian-born software entrepreneur who runs the Philanthropia Trinity, another international network of philanthropists. “What is the point of earning a high return in China if my money is helping to build Dickensian working conditions? If I have $5 billion, and am giving $4 billion away, do I really want a 17% return on activities that are wrecking the world?” To deal with that problem, the investment industry will need to improve on the strategies and products it currently offers for “ethical” or “socially responsible” investment, which often amount to little more than avoiding shares in, say, tobacco, arms manufacturing or oil.

The phrase most often used to describe the new approach to giving is “venture philanthropy”. This was first used in the 1960s by one of the Rockefellers, but is still practised relatively rarely. Perhaps the best example is a firm called Venture Philanthropy Partners. Run by Mario Morino, who made his fortune in software, it specialises in mid-sized non-profit organisations in the Washington, DC, area that work well enough, but lack the capital and talent to expand. With a $30m fund raised through a community foundation, Mr Morino behaves much like a venture capitalist. He is working intensively with 12 non-profit organisations, helping them to develop a business plan for growth and to recruit managers and board members.

Old dogs, new tricks

New foundations may be learning from the mistakes of the old ones; but what can be done to reform established foundations that are underperforming? With America's Congress showing increased interest in foundations, Senator Charles Grassley has proposed tough new laws. His reforms would “dramatically transform the relationship between the federal government and foundations”, says Adam Meyerson of the Philanthropy Roundtable, an industry body. Among other things, Senator Grassley is proposing a five-yearly review of foundations' charitable status and a formal government ratification regime. But Mr Meyerson thinks it would be far better for the government properly to enforce the laws that are already in place.

Better regulation is on the agenda in Britain, too, where charity is still governed by an act passed in 1601. “The governance of charities and non-profits is generally poor,” says Geraldine Peacock of Britain's Charity Commission, which under new legislation due to take effect this year will become much more independent of government. Like Senator Grassley, Ms Peacock thinks that a charity should be licensed for a limited time—say five years—and then have to reapply.

Encouragingly, many of the older foundations themselves are becoming more concerned about effectiveness, and have started demanding more information on how the money they provide is spent, says Mr Fleischman. The recent transformation of the Edna McConnell Clark Foundation shows that an inefficient old organisation can turn itself into a cutting-edge operation. It used to hand out grants in the traditional manner for a wide range of good causes. But in the late 1990s, a new head, Mr Bailin, decided to concentrate its activities in a single field, youth development. Working closely with its chosen organisations, notably Harlem Children's Zone, it has helped them become more effective and serve many more people.

The biggest question of all is how to measure the performance of a philanthropic organisation. A huge amount of work is going on in this field, but it is still more art than science—particularly when it comes to the fuzzier goals of some philanthropists, such as “empowering people”, “increasing the effectiveness of civil society” or “fighting climate change”.

Measures involving the so-called double bottom line (financial plus social performance) or triple bottom line (financial, social and environmental) are readily susceptible to statistical manipulation. So are popular concepts such as “changed life”—a combination of the number of people affected by an initiative and the extent to which it improves their lives.

One danger is to pay too much attention to managing inputs, which are easier to measure than output. Another is to concentrate donations on those activities that can be easily measured, such as the number of vaccinations given, even where that may not be the most effective way of tackling a problem.

Donors also need to strike the right balance, so that on one hand they ask for enough information to be able to monitor the effectiveness of the organisations they fund but on the other they do not bog them down in form-filling bureaucracy. The Gates Foundation has a good reputation for getting the mix right and tailoring it to individual circumstances.

“The risk with any metric is that people will come to see it as a description of reality, rather than a tool for a conversation about that reality,” says Rowena Young of the Skoll Foundation. “One metric or another can function well only when managers know why they are measuring and for whom...In the world of social value-creation, context is king.”

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The good company

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Is corporate philanthropy worthwhile?

CORPORATE giving has long had a reputation as the sleaziest corner of philanthropy. Although usually nominally independent of the companies whose names they take, corporate foundations in practice are often treated as a sort of slush fund into which the chief executive can dip to help a pet cause, enhance his status in the community or even cement a business relationship with a donation to a cause close to a business partner's heart. Corporate philanthropy has been coming under greater scrutiny since the collapse of Enron, because many people believed that donations to various Enron board members' good causes may have made them less willing to hold the firm's top executives to account. Companies are now having to work harder to justify their philanthropy on strategic grounds.

The best justification, and perhaps the only intellectually rigorous one, is that philanthropy is in the enlightened long-term interest of shareholders. This is a key argument in a new book, “Compassionate Capitalists: How the Leading CEOs are Doing Well by Doing Good”, by Marc Benioff, the boss of salesforce.com. The book contains two dozen articles by captains of industry, including Alan Hassenfeld of Hasbro, Jeffrey Swartz of Timberland, Steve Case of AOL, Michael Dell of the eponymous computer-maker and Jean-Pierre Garnier of GlaxoSmithKline. All of them argue—some more convincingly than others—that their philanthropy is good for shareholders, at least in the long run. Mr Benioff argues that giving his staff time to volunteer in the community improves his company's ability to recruit top talent.

Corporate philanthropy is also becoming more important in developing countries, where firms may feel the need to support local communities by contributing through their foundations to health care, education and so on. In an article in a new book, “The Accountable Corporation”, Messrs Porter and Kramer note that Nestlé, for example, now invests a lot in what it calls “milk-production systems” in developing countries, realising that a decent infrastructure is needed to ensure a reliable supply.

“The dominant trend in corporate philanthropy is to do giving that reinforces a firm's core strategy,” argues Trevor Neilson of the Global Business Coalition on HIV/AIDS. Thanks to shareholder pressure, increasingly the only acceptable philanthropy is the sort that enhances profits. Mr Neilson is a keen advocate of “cause-related government relations”, which means that a firm will help a government to deal with a social problem in the hope of getting favourable treatment in the future. For example, 26 companies so far have made commitments to help the Chinese government with its AIDS strategy, which Mr Neilson says will allow them to form a valuable relationship with the government. Perhaps.

Some of the new philanthropists believe that they are doing good simply by running their business. Thus, Mr Omidyar argues that eBay does its bit by empowering people and promoting trust between strangers. Most importantly, it is creating wealth to be shared around. After all, without wealth-creation there would be no chance of philanthropy.

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The rise of the social entrepreneur

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Whatever he may be

UBS, a Swiss private bank that counts many of the world's richest people among its clients, is conducting an interesting experiment in Brazil, Mexico and Argentina. It has formed an alliance with Ashoka, a global organisation that identifies and invests in leading “social entrepreneurs”. The alliance is offering a new prize for social entrepreneurship, which UBS's Martin Liechti admits is an excuse to bring together two groups of people who might otherwise never meet. “As the biggest wealth manager in the region, we are at the crossroads between capital and ideas—so why not bring the people with capital together with the people who have ideas?”

The social entrepreneurs that are shortlisted must have been working successfully with Ashoka for at least three years. Winning the prize is not really the point. Simply being selected to be in the room with a bunch of wealthy people gives the social entrepreneurs great credibility with potential donors, and even runners-up have a good chance of coming away with a new financial backer or some other form of help. Héctor Castillo Berthier, who runs an innovative project for troubled Mexican teenagers, came third in last year's Mexican prize, but still got a crucial donation and free use of office space.

Ashoka is not alone in bringing social entrepreneurs together with the wealthy and powerful. Social entrepreneurs now rub shoulders with the world's business and political elite at the World Economic Forum in Davos, under the auspices of a sister organisation to WEF, the Schwab Foundation for Social Entrepreneurship. This year, the people selected included Rory Stear, founder of Freeplay, a company dedicated to the spread of cheap, sustainable energy for all; Jim Fruchterman of the Benetech Initiative, a non-profit organisation that makes technology available to disadvantaged communities; and Victoria Hale, founder of OneWorld Health, which works with the Gates Foundation (among others) to make low-cost drugs available in poor countries.

Waiting for a productivity miracle

Ashoka was founded in 1980 by Bill Drayton, a former McKinsey consultant, who expects the rise of social entrepreneurship to generate huge benefits. He says it is now helping to bring about a productivity miracle in what he calls the “citizen half of the world” (education, welfare and so on), a sector that for three centuries has lagged behind the “business half of the world”, where productivity has soared and vast amounts of wealth have been created thanks to its competitive, entrepreneurial culture. The emergence of more social entrepreneurs, and their improved access to growth capital as they get better connected to philanthropists, is creating enormous productivity opportunities for the citizen sector, argues Mr Drayton.

The citizen sector is defined somewhat loosely, but is largely made up of government plus the non-profit sector. Both government and non-profits have traditionally been run inefficiently. The productivity miracle detected by Mr Drayton is due both to a shift from government provision to more efficient private provision (by both for-profit and

non-profit organisations) and by an increase in the efficiency of the non-profit sector.

The improvement in non-profit organisations' efficiency may still have some way to go. In 2004, Bill Bradley, a former presidential hopeful for the Democrats, and two McKinsey consultants claimed in an article in the *Harvard Business Review* that, in America alone, there was a "$100 billion opportunity" for the non-profit sector to improve its efficiency through better management. But is social entrepreneurship the best way to achieve that?

Shining examples 5

Leading social entrepreneurs

	Organisation	Nationality	Background
Jeroo Billimoria	ChildLine India Foundation	India	Children's rights
Somsook Boonyabancha	Community Development Institution	Thailand	Land rights
Peter Eigen	Transparency International	Germany	Anti-corruption
Oded Grajew	Instituto Ethos	Brazil	Citizen sector
David Green	Project Impact	United States	Public health
Alice Tepper Marlin	Social Accountability International	United States	Labour
Pearl Nwashili	StopAIDS Organisation	Nigeria	Public health
Fabio Rosa	IDEAAS	Brazil	Renewable energy
Orri Vigfusson	North Atlantic Salmon Fund	Iceland	Environment
Muhammad Yunus	Grameen Bank	Bangladesh	Microfinance

Source: Ashoka

There is no easy answer, not least because nobody is sure what exactly the term means. In a book charting the rise of social entrepreneurship, "How to Change the World: Social Entrepreneurs and the Power of New Ideas", David Bornstein notes that most discussion of social entrepreneurship tends to revolve around "how business and management skills can be applied to achieve social ends". He himself sees social entrepreneurs as "transformative forces: people with new ideas to address major problems who are relentless in the pursuit of their visions". The late management guru Peter Drucker, typically quick to spot the trend, defined social entrepreneurs as people who raise the "performance capacity of society".

Mr Schramm of the Kauffman Foundation, which promotes a better understanding of entrepreneurship, says that being an entrepreneur means being a risk-taker, but a high risk of failure may be the last thing that many non-profits need. And, surely, "every entrepreneur is a social entrepreneur," says Mr Schramm. "A successful entrepreneur...creates wealth—and without wealth there is no surplus capital to turn over to charitable activity."

Mr Omidyar, too, is uncomfortable with the label, which he feels implies a disapproval of profits that he does not share. "I think of myself as an entrepreneur, and I have a social view, but I don't call myself a social entrepreneur," he says. But his fellow philanthropist from eBay, Mr Skoll, thinks social entrepreneurship has something going for it. The mission of his eponymous foundation is "to advance systemic change to benefit communities around the world by investing in, connecting and celebrating social entrepreneurs".

Among other things, Mr Skoll has endowed the Skoll Centre for Social Entrepreneurship at Oxford University's Saïd Business School. This is part of a growing trend for academic institutions, including nowadays most business schools, to take the phenomenon seriously. Harvard Business School started teaching a course on social enterprise 12 years ago.

Mr Schramm worries that some of these courses are more likely to turn students against capitalism. But Mr Whitehead, a former Goldman Sachs boss who is the driving force behind the HBS course, sees it as part of a trend among the elite in many countries who increasingly want to make not just money but "a difference". The money may not be as good as in business, but "a bright young person can have more of an impact on any non-profit in his first five years than on Goldman Sachs, which is full of bright young people. In their first year they could make ten suggestions that would improve the non-profit operation because they have been trained in practical business ways of thinking."

People like you and me

Certainly the number of business-school graduates going into the non-profit sector has increased. That appeals to the new philanthropists, who want to see people like themselves in charge of the non-profit organisations they support. But these new professionals may achieve as much by using the latest management techniques to improve the performance of existing non-profit organisations than by creating new ones through social entrepreneurship.

Mr Collins, the management guru, says getting the right people is arguably even more important in the non-profit world than it is in business, because it is often harder for non-profits to get rid of employees once they are "on the

bus". Business leaders can fire people more easily and can spend money on buying talent. But some social entrepreneurs have found their own ways of securing top talent. Wendy Kopp, who in 1989 founded Teach for America—a non-profit organisation that gets graduates from top universities to spend the first two years of their careers teaching children from low-income families—made it clear from the start that only the best would do. By last year, over 97,000 people had applied to work for her organisation, but only 14,000 had been accepted. Ms Kopp's ability to pick and choose boosted her credibility with her philanthropic backers and enabled her to raise more money.

A growing number of non-profits now have state-of-the-art marketing departments. Indeed, it can sometimes seem that the marketing has become more important than the mission. One technique is to use "charity muggers" on commission to collar people in the street and get them to sign a standing order. For a while this was used in Britain by Oxfam, but the development charity now thinks that raising money this way does not pay. Far better to tap into the public's concern about where its charitable donations are going, as Oxfam has done with its hugely successful Christmas gift catalogue, offering gifts such as sponsoring a goat in an African village for £24 or providing safe water for 1,000 people for £720. "The public want to be transactional, to have a more direct relationship with where their money is going," says Barbara Stocking, Oxfam's boss.

Many non-profit organisations have been wary of working with big donors because their money can come with too many strings attached. But that is starting to change. Oxfam now wants to raise more money from the sort of wealthy philanthropists it has not targeted in the past—if only because in Britain there haven't been many of them, says Ms Stocking. "I'm not sure we have been asking for enough money," she muses.

But the main problem for many non-profit organisations is how to get bigger. "One of the problems is that well-run non-profits don't necessarily grow," says Nigel Morris, the co-founder of Capital One, a credit-card company. True, growth isn't everything. Indeed, Mr Collins worries that non-profits will put scale before genuine effectiveness: "One of the markers of mediocre companies is that they become obsessed with scale and growth," he says. But donors need to decide if they simply want to buy services from a non-profit, or whether they want to invest in helping the organisation grow. If growth is important to them, they need to become a lot less squeamish about overheads.

The virtue of overheads

"In the business sector, people are very comfortable with the idea of investing in an organisation, and the need to build up its infrastructure. In the social sector, the tendency is to invest only in a programme; there is very little investment in building organisations," says Mr Collins. Yet often, in yielding to public pressure to keep down overheads, "non-profits sacrifice efficiency for virtue," says Carnegie's Mr Gregorian.

There is no merger-and-acquisition market in the non-profit world. And for all sorts of reasons, there are far too many non-profits. Philanthropists could help by encouraging consolidation, says John Studzinski, co-head of HSBC's investment bank and an active philanthropist. "In homelessness work, I'm a great advocate of consolidation. There are about 40 homelessness projects in London; only eight are any good," he says.

There is also a role to be played by philanthropists in encouraging non-profits to develop other sources of finance, to reduce their dependence on the goodwill of donors. Providing fee-generating services is one strategy. Doing work for the government is another. Many non-profits have long generated revenues in this way.

Philanthropists can even encourage non-profits to move towards becoming for-profits, able to stand entirely on their own feet. This is what Mr Omidyar hopes to achieve with his $100m donation to Tufts University to invest profitably in microfinance. But the idea may face a lot of cultural resistance. "How do you get the citizen sector to change its attitudes so that it allows institutions to have incomes that are at least equal to outgoings?" asks Ashoka's Mr Drayton.

He is now trying to promote for-profit partnerships between big companies and community groups in some of the most impoverished parts of the world. "Working with both sides, we map a new value-added chain, ranging from product design to production to distribution to servicing; that delivers a far better service to the ultimate customer faster, better and more economically. Ending centuries of non-communication brings so much value that both business and citizen groups emerge as huge winners as well," he says.

For example, community groups in Mexico's slums now work with Cemex, a huge cement firm, to create a market for its cement among the slum dwellers, greatly reducing the cost of adding extra rooms to their dwellings, providing funds for the non-profit groups and turning a (still small) profit for Cemex. The social entrepreneurs running the community group have the trust of the locals without which the big company would never be able to enter the market, says Mr Drayton. Other similar "hybrid value-added chains" that combine business and social purposes are being developed between groups of forest-dwellers and forestry firms, and small farmers and irrigation companies.

Meanwhile, Ashoka hopes that its relationship with UBS will flourish, and that prizes will soon be awarded across

Latin America and Asia. But as well as highlighting the growing role of social entrepreneurs, this experiment also points to another new trend: a more active role for intermediaries in the emerging philanthropic capital market.

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Virtue's intermediaries

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A host of new businesses is trying to make the philanthropic market work better

LEGEND has it that New Philanthropy Capital (NPC) was founded in the Goldman Sachs canteen in London in 2001. After Goldman went public, Gavyn Davies, then its chief economist, and another top banker, Peter Wheeler, had pocketed enough money to enable them to do some serious giving. But when they tried to pin down the best place for their money to create maximum impact, "We found there wasn't enough information produced in a hard-headed, independent, high-quality way, made available to all," recalls Mr Davies. So they decided to create NPC as the equivalent of an equity-research firm for the philanthropic marketplace.

It had the added attraction of providing leverage, the holy grail of the new givers. "We wanted our own charitable donations to be the foundation of a much bigger edifice. This was an investment designed to have a levered effect on other people's giving," says Mr Davies. "We wanted to increase giving by enabling donors to be more confident that they were having an impact on people's lives."

For now, the research effort, headed by Martin Brookes, a former senior economist at Goldman Sachs, is confined to the charity sector in Britain. NPC is not providing ratings at present, but the equivalent of "buy" recommendations through sector reports such as "Grey Matters, Growing Older in Deprived Areas". In preparing these reports, NPC asks the charities seeking funds four simple questions: What is it you do? Why? What is success? And what is evidence of success? The firm also does some secondary research, such as summarising and translating academic work and making it more widely available.

"When you come into this world from Goldman, you realise how screwed up it is as a market," says Mr Brookes. "We are trying to fix the plumbing." They are not alone. Efforts are under way to develop philanthropic versions of most of the main sectors of the capitalist marketplace: social-investment banking, social-investment management, private banking, consulting, data services and research. Though currently the organisations providing these services are relatively small, there appears to be enough demand to enable a successful operation to grow fast.

"The biggest constraint on our growth has been the ability to recruit top talent," says Mr Davies. "Only a few people are willing to come out of a career in banking to do this." An analyst at NPC can expect to earn £22,000-48,000 ($38,000-84,000), a small fraction of what they would make at Goldman.

In any marketplace, knowledge is power. NPC is attracting interest in America, which currently has no direct equivalent. The big foundations, in particular, do lots of research, but they tend to keep it to themselves. The nearest counterpart to NPC in America is Geneva Global (GG), but it covers only giving opportunities outside America. GG's 140 employees work with a network of over 500 voluntary associates in over 100 countries. It mostly concentrates on small projects, which it thinks have a greater impact.

Famous brands

"In philanthropy, the stuff that will deliver most often gets least," says GG's boss, Eric Thurman. Brands count for a lot in the world of giving, and many people like to give to familiar organisations. For instance, the Red Cross, despite heavy criticism of its handling of donations after September 11th 2001, collected almost 70% of the money given for relief work after Hurricane Katrina wrecked New Orleans.

GG challenges the big charities by finding a small, local group that is doing something well and is ready to scale up its operations. It sends potential donors a monthly catalogue with a choice of evaluated projects, and later provides feedback on what their money has achieved. "We want to be known for making a direct connection between the money you raise and lives changed," says Mr Thurman.

For more comprehensive information about who is doing what in the philanthropic world, there is GuideStar. Nicknamed the "Bloomberg screen of philanthropy", it was founded in America in 1994 by Buzz Schmidt and makes available online, free of charge, the tax-return data filed by 1.5m charitable organisations, together with additional

information. It has more than 400,000 registered users, and for a fee it offers detailed analysis of the data—such as which organisations do what in a particular area, how much a charity pays its chief executive relative to the average, and so on.

Mr Schmidt is now busy setting up similar services abroad. Last year GuideStar was launched in Britain, putting data online that had been sitting on paper in Charities Commission and tax-office cabinets, largely unlooked at, says Les Hems of the Institute for Philanthropy, the parent organisation of the British end of GuideStar. The institute was founded in 2000 to help foster charitable giving in Britain, not least by starting, and then spinning off, new organisations that solve particular problems. Britain's Treasury gave it £2.9m, topping up £1m raised from donors. Now GuideStar is trying to secure continuing public funding, as well as fees from licensing data to organisations such as NPC. Other versions of GuideStar are planned in India, South Africa and Australia.

Not everyone is impressed. Mr Porter, the Harvard strategy guru, thinks that GuideStar's figures are too superficial to be much use in judging, say, the performance of foundations. He helped establish the Centre for Effective Philanthropy, which among other things produces donor perception reports based on confidential surveys of organisations that receive money from foundations. Initially foundations were reluctant to publish the reports, especially the critical ones, but that is starting to change. “Smart non-profits are realising that they can do well by being more transparent, and talking about their successes and failures,” says Tony Knerr, a philanthropy consultant.

“The social sectors do not have rational capital markets to channel resources to those who deliver the best results,” says Mr Collins. According to a recent article in Stanford's *Social Innovation Review*, in America raising $100 can eat up anything from $22 to $43. In Britain, the average cost of finance to charities is around 25%, which is very high relative to other industries, notes NPC's Mr Brookes.

The traditional grant-making process is a large part of the problem. Donors would generally rather fund a project than invest in building an organisation. If a charity has money in the bank, they will ask why they should provide any more, and what exactly their donation will be used for.

Not everybody is so short-sighted. For example, the Ford Foundation is encouraging the greater use of debt and debt-like instruments because “there is a growing number of income-generating activities, and donors want to help borrowers to get a credit rating so they can go to the commercial market,” says Susan Berresford, the foundation's boss.

In Britain, Venturesome has been arranging unsecured loans for charities, typically bridging finance for those waiting to be paid a promised grant. And in America College Summit, which aims to raise the proportion of young people going to college in low-income areas, recently secured $15m in growth capital to fund its ambitious expansion plans for the following three years. Previously, it had to raise finance for expansion one project at a time, a costly, time-consuming process.

The man responsible for the capital injection, George Overholser of Non-Profit Finance Fund Capital Partners, reckons this is only the first of many private placements of donor capital for non-profits. NFF Capital helps non-profits to raise capital for the organisation as a whole, rather than for an individual project. Mr Overholser claims to have a pipeline of ten charities he considers suitable for similar financing.

A confusion of capital

The inadequate accounts of non-profits have proved a big complication. In America at least, all inflows of money are treated as revenue, even if it is really investment capital. Yet to raise growth capital, as College Summit has done, it is crucial to distinguish between money a non-profit receives for services rendered and money it is given to build its organisation. Mr Overholser has devised a common reporting method to track how the money is being spent, to be used both by donors and for internal management purposes. This will introduce concepts from the for-profit world, such as “burn rate” (the rate at which capital is being used), giving all concerned a better idea of how well the expansion is going. Now non-profits can work backwards from their expected long-term sustainable sources of finance to work out their current need for capital, and how to structure it, says Mr Overholser.

In the capital markets, there has been a proliferation of investment opportunities, from mutual funds to complex derivatives. Something similar may be under way in the philanthropic world, ranging from investments that pay a decent return on money put to worthy uses to structures that allow donors to give their money away more effectively. In America, Google.org has just invested $5m in the Acumen Fund, which channels donors' money to a portfolio of entrepreneurial poverty-fighting organisations.

In Britain, NPC and the Charities Aid Foundation recently launched a couple of funds that will allocate money to a portfolio of charities, monitor its impact and keep the donors informed about progress. The first two funds concentrate on charities in particular sectors, as their names suggest: the Engaging Young Lives Fund and the Fulfilling Older Lives Fund.

A host of new tax-favoured opportunities have been coming on stream at the same time, guided by Sir Ronald Cohen, a private-equity grandee, philanthropist and chairman of the British government's Social Investment Taskforce. For example, Bridges Community Ventures, which invests in businesses in deprived areas of Britain, has done well with its first fund and is raising another. Charity Bank—"the compassion of a charity and strength of a bank"—has been set up to provide banking services exclusively to charities. Last year, the government launched the Community Interest Company, which engages in commercial activities for community purposes that are not primarily driven by profit. They can pay dividends and borrow, but can be sold for full value only if the money remains in the charitable sector.

Driven by growing demand from wealthy clients, private banks such as Goldman Sachs, HSBC, Coutts and UBS are now scaling up philanthropy advisory services way beyond traditional tax and inheritance advice and asset management. A growing amount of consulting advice, too, is available to philanthropists and those they fund. Rockefeller Philanthropy Advisors is probably the leading consultancy concentrating solely on the giving side.

Advise and consult

Some of the big management consultants are also expanding their non-profit businesses. In 1999, McKinsey created a separate non-profit practice specialising in three main areas: global public health, foundations, and international aid and development. In general, it charges half its regular fee for such work, though for a particularly deserving cause it may drop it even further or forgo it altogether. Its clients include the Gates Foundation and Bono's campaigning organisation, DATA (Debt, AIDS, Trade, Africa).

Bain adopted an even more ambitious strategy. In 2000, it launched Bridgespan, a stand-alone consultancy and executive-search business for non-profits. Run by the former head of Bain, Tom Tierney, Bridgespan aims lower than McKinsey, at mid-sized non-profits. It now employs 75 people who typically earn 30-40% less over a five-year period than they would at Bain. Even so, last year it had 1,700 applications for 18 jobs. Bain would like Bridgespan to spread to other countries, but there is plenty left to do at home, says Mr Tierney: "We are serving only 10% of our demand right now, and turning down the vast majority of approaches from serious clients."

Perhaps the boldest, or craziest, idea is to launch a social stockmarket. Mr Skoll thinks it may happen one day, though no one has any idea what sort of security might trade on the exchange. "Perhaps there could be some sort of system involving social merit points," he muses; something akin to the recent development of carbon-emissions trading.

"The proliferation of market services is going to be very good for philanthropy," says Mr Myerson of the Philanthropy Roundtable. "There will be more services, more choice, more information, more opportunities to capture people's philanthropic imagination." But in the end, those who are trying to produce a philanthropic version of the capital markets must answer a billion-dollar question: how do you measure success? The original sort has an incontrovertible answer: profits. But a philanthropic equivalent will be nothing like as straightforward.

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Faith, hope and philanthropy

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What the new breed of donors can do—and what it can't

THE growing enthusiasm of the rich for philanthropy, together with their determination to see their money used to better effect, has prompted talk of a new "golden age of philanthropy". But much remains to be done before today's beneficent billionaires can claim to follow in the footsteps of such giants of giving as Carnegie, Rockefeller and Rowntree.

The willingness of so many of the new wealthy to apply part of their fortune to "making the world a better place" is certainly welcome. True, there are questions to be asked about what exactly is motivating them, and whether they are doing the right things to tackle society's problems. Yet philanthropy, free of the short-term pressures from voters and shareholders that constrain governments and for-profit companies, may be one of the best hopes for solving problems such as the spread of AIDS, poverty and climate change.

The new philanthropists rightly insist on making their money go further, because in the past a lot of donors' cash has been wasted. One way of introducing more leverage is to adapt elements of the capital markets for use in this sector. Many innovative businesses have sprung up to provide some of the infrastructure of this new philanthrocapitalism. But in the absence of market forces, much giving remains less effective than it should be.

To-do list

To improve matters, the first thing that is needed is better measurement of the impact of philanthropy. When Carnegie built libraries, or the Rowntrees and Cadburys built social housing, it was easy to see the benefits with your own eyes. But how do you know whether Omidyar Network is achieving its goal of helping "more and more people discover their own power to make good things happen"? Mr Davies, the co-founder of New Philanthropy Capital, concedes that measurement is difficult, but insists it is not impossible: "Some of these things from an economic point of view are unmeasurable, but no more so than measuring GDP in the service sector, which we do, though it is very hard."

The second requirement is greater transparency. There are still far too many philanthropists trying to do the same thing, often unaware that they are duplicating each other's good works. More transparency would help to avoid wasting scarce resources and promote consolidation in parts of the sector. Failures also need to be more frankly acknowledged, so that philanthropists can learn from each other's mistakes.

Compared with the resources of governments and businesses, philanthropic capital is still tiny, so it needs to be used with the utmost care to ensure that it will make a real difference. Yet many of the activities funded by philanthropy do not add much value and could be funded by more risk-averse investors, such as the state.

That said, some of the new philanthropists are doing their best to use their money in innovative ways which, if successful, could then quickly be scaled up by government or business. Indeed, a growing number of them recognise that the best way to attract the capital needed to achieve scale quickly is to find potentially profitable ways of solving problems.

The third thing that is needed to make philanthropy better is greater accountability. Democracy and plutocracy do not sit comfortably together, and even when donors' money is being spent in non-democracies, the democratic world is likely to take a growing interest in what is being done. The new philanthropists will have to get used to public scrutiny, cynicism and even active hostility—together with a good dose of *Schadenfreude* if and when their schemes fail.

This should not surprise them. They are, after all, making increasing use of mass-marketing and public campaigns to support their causes, as Bono did with his initiatives "Make Poverty History" and "One" around last year's G8 summit, seed-financed by Mr Gates and Mr Soros. The flip side of that is the risk of an equally high-profile public backlash if they do not deliver. But they should persevere, not least because they are far likelier to make an impact if they can get the public on their side. And even if some of their projects do not come off, many will.

One way in which these new philanthropists are already making a difference is by improving the running of a big chunk of society—charities, non-profits, non-governmental organisations and the social sector—where

amateurishness and inefficiency used to be the norm. They are introducing the best techniques from business and ensuring that market forces are being given a much bigger role. This amounts to an industrial revolution in what Rockefeller called the “business of beneficence”. It has only just started, but rich and poor alike should hope that it succeeds.

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Private equity and technology

The great tech buy-out boom

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Will the enthusiasm of private-equity firms for investing in technology and telecoms end in tears, again?

PRIME COMPUTERS, Rhythm NetConnections and XO Communications—all names to drain the blood from the face of a private-equity investor. Or so it was until recently, when investing in technology and telecoms suddenly became all the rage for private-equity companies. These investment firms—labelled “locusts” by unfriendly Europeans—generally make their money by buying big controlling stakes in companies, improving their efficiency, and then selling them on.

In the late 1980s, Prime Computers became private equity's first great “tech wreck”, humiliating investors who thought they understood the technology business and could nurture the firm back to health away from the short-termist pressures of the public stockmarket. After Prime failed, private-equity firms spent the best part of a decade focusing solely on the old economy. Only in the late 1990s, when the new economy was all the rage, did they pluck up the courage to return to tech and telecoms—a decision some of the grandest names in the industry were soon to regret. Hicks, Muse, Furst and Tate (Rhythm NetConnections) and Forstmann Little (XO) have both been shadows of their old selves since losing fortunes on telecoms.

Now, investing in technology and telecoms is once again one of the hottest areas in the super-heated private-equity market. The multi-billion-dollar question is: will this round of investment end any less horribly than the previous two?

Last month TDC, a Danish phone company, was finally acquired after a bid of $15.3 billion by a consortium including European giants Permira Advisors and Apax Partners, and American veterans Kohlberg Kravis Roberts (KKR), Blackstone Group and Providence Equity Partners. In the past five years, there has been private-equity involvement in about 40% of telecoms deals in Europe.

On the other side of the Atlantic, the action has focused mainly on technology, rather than telecoms. Last summer, a consortium including Silver Lake Partners and KKR completed the biggest private-equity tech deal to date, buying SunGard Data Systems, a financial-technology firm, for $11.3 billion. Since then the deals have continued to flow. The $1.2 billion acquisition of Serena Software by Silver Lake is due to be completed by the end of March. Blackstone and others are said to be circling two IT outsourcing firms—Computer Sciences and ACS.

There are reasons to hope that this time will be different. In telecoms, for instance, private-equity firms are mostly trying to buy established firms—often former national monopolists—that, while they might be threatened by internet telephony, have strong cash flow, physical assets and plenty of scope to improve the quality of management. These are the sorts of characteristics private-equity investors thrive on. By contrast, the disastrous investments in the late 1990s were in new telecoms firms that were building their operations.

In technology, private-equity interest has grown as the industry has matured, and cash-flow and profitability have become more predictable. Until recently, it has been the norm for tech firms to plough back all their profit and cashflow into investing in the business. They have carried no debt and paid no dividends. Now private-equity firms see the opportunity to pursue their classic strategy of buying firms by borrowing against cashflow, and then returning money to shareholders. Glenn Hutchins of Silver Lake thinks the tech sector is now in a similar condition to the old economy in America in the early 1980s, which is when private equity first started to have an impact, by restructuring and consolidating many industries.

According to a report on the software industry, circulated by one private-equity firm, simply by borrowing one and a half times estimated 2005 profits, a firm such as BMC could buy back 41% of its shares and BEA Systems could buy back 32%. Compared with the pharmaceutical sector, which has a similar growth rate and profit margin, software looks woefully under-geared. Strikingly, even firms too big—at least for now—to be subject to the attentions of private-equity firms have started to pay dividends (not least Microsoft) and take on debt (Cisco). ACS recently announced that it will buy back up to half its shares, in a move apparently designed in part to reduce its appeal to Blackstone.

Silver Lake, with Texas Pacific Group, has provided much of the inspiration for today's private-equity love-in with tech. In 2000, the two firms invested $700m to buy Seagate Technology, a computer disk-drive maker. The value of that investment is now conservatively estimated at about $6.8 billion, about two-thirds of it already safely banked. Just as Prime Computers made private-equity firms think that tech deals were impossibly hard, Seagate has transformed their view of investing in technology, says Josh Lerner of Harvard Business School. He now thinks that the pendulum may have swung too far the other way, with many private-equity firms regarding investing in technology as easy.

The acquisition of SunGard has opened up the possibility of far larger deals, especially with its model of a consortium of private-equity buyers combining generalist funds and a technology specialist such as Silver Lake. The ability to do bigger deals is also being boosted by the ready availability of credit. As recently as 2003, private-equity firms struggled to raise two-to-three times a target company's EBITDA (earnings before interest, tax depreciation and amortisation). Now five to seven times EBITDA is available. Serena was purchased at 11 times EBITDA—a record multiple for a tech deal.

Private-equity firms are raising huge amounts of capital from profit-hungry investors. The credit markets are in a generous mood, too. Strategic corporate buyers are also returning to the takeover market—France Telecom outbid private-equity bidders for Spain's Amena mobile operator last year, for example.

But all this is combining to push up prices to levels at which it may be hard for private-equity firms to sell their acquisitions profitably. “A key question is whether the current favourable macro environment of low interest rates and large amounts of capital available will be there at the time of exit three-to-five years from now,” says Nikos Stathopoulos of BC Partners. Indeed.

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Private equity in Germany

Friendly locusts

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A swarm of foreign investors visits the Finanzplatz

PRIVATE-equity funds and other financial investors are fast becoming part of the fabric of corporate Germany. The term “locust”, used disdainfully to describe them last year by Franz Müntefering, now the country's vice-chancellor, is changing into one of near endearment. So there was little fuss this week when 1,500 locusts and their sidekicks descended on Frankfurt for their annual bash, SuperReturn 2006. Among them were Henry Kravis of Kohlberg Kravis Roberts, Leon Black of Apollo Advisors and Stephen Schwarzman of Blackstone.

Their first day was devoted to Germany and highlighted the importance of private equity as a funding alternative for the *Mittelstand*, the small and medium-sized firms that are traditionally the backbone of the economy. Some 5,700 German companies already have private-equity firms among their shareholders, and the trend is rising.

But there is now too much money chasing the best deals, exacerbated by the fact that hedge funds are playing with private-equity stakes too. Overpayers should bear in mind a McKinsey study three years ago which suggests that, even among the best investors, one out of ten deals will fail and another three will perform badly, while one out of ten will be a winner that provides up to 35% of the portfolio's total return.

Portfolios of bad loans and swathes of run-down housing have attracted the biggest private-equity deals in Germany. Last year Terra Firma of Britain bought 150,000 dwellings from E.ON, an energy utility, for around €7 billion ($8.3 billion). This week Fortress, an American fund, bought 47,600 homes from the east German city of Dresden for €1.7 billion. German investors, such as banks or insurance companies, have neither the balance sheets nor the guts to take on these monsters.

The same goes for portfolios of loans. Lone Star, a big American fund, recently bought its second entire bank, AHBR, which was close to bankruptcy. In the work-out, Karsten von Köller, Lone Star's boss in Frankfurt, is playing hard-ball with local banks which had pumped in last-minute funding. Ironically, then, the highest-profile locust of the moment is actually German.

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Chinese aviation

On a wing and a prayer

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China's airlines are failing to translate rapid growth into profits

DESPITE a rousing flying display from the gigantic new Airbus A380, visitors at this week's Asian Aerospace show, which opened on February 21st, were looking to the north as much as up. After a quarter of a century at Singapore's Changi Exhibition Centre, Asian Aerospace—the world's third biggest air show—will move to Hong Kong from next year. The reason, as so often these days, is the growing pull of China.

Granted, there is excitement about India, Dubai and south-east Asia. But for the aerospace industry, China's combination of rapid growth and huge absolute numbers is the real prize. Chinese airlines carried 138m passengers last year, a number that has doubled in the past five years and already turned the mainland into the second largest aviation market behind America. The Chinese government expects the figure to double again over the next five years. Freight volumes are growing even faster, increasing by 20% last year.

As a result, China is buying aircraft as never before. In 2005, it accounted for 219 planes, or fully one-fifth of Airbus's global orders in a record year. Boeing's latest analysis forecasts that over the next two decades, China will need 2,600 new planes, worth more than $213 billion.

But while airframe-makers and their suppliers are rubbing their hands, China's airlines are so far experiencing almost profitless growth. True, China has done wonders to mobilise the country, building the infrastructure needed to support the growth of its aviation industry and improving its safety. China now has 130 airports handling more than 1m passengers a year, with another 55 international airports planned by 2020. But despite a big jump in passenger numbers and revenues, the entire sector has reported measly profits of just 10 billion yuan ($1.2 billion) in the past five years.

This year, Air China is the only one of the big three carriers expected to be in the black. China Southern and China Eastern have already warned of sharp losses. While their American rivals are in even worse financial straits, this performance compares badly with other highly profitable Asian carriers, such as Cathay Pacific and Singapore Airlines—particularly since China has worked hard to consolidate its numerous carriers to six bigger ones. Nor is China having much luck with low-cost carriers, which are a growing success elsewhere in Asia. Its own versions—Okay Airways, Air Spring and United Eagle—are struggling.

Part of the airlines' failure to make profits is simply the consequence of rapid expansion. Investing in all those new planes means most Chinese airlines are heavily in debt. A more serious issue, despite limited liberalisation over the past few years, is the continued presence of the state's dead hand. Ticket prices, for example, remain more or less regulated, preventing carriers from practising the sophisticated yield management of western peers. The government is planning to raise landing charges for domestic airlines in order to bail out the country's loss-making small and medium-sized airports, of which there are still far too many—but that will further squeeze the domestic carriers. Meanwhile, a domestic jet-fuel monopoly means fuel accounts for an average of 40% of costs at Chinese airlines, compared with 24% for airlines worldwide.

Another issue is rising labour costs due to a lack of qualified staff. In particular, China will need more than 1,000 pilots a year over the next decade, but with only one state flying school, Guanghan near Chengdu in Sichuan province, it can train 600 at most. Air China admitted this month that its planned introduction of 20-30 new aircraft in 2006 depended on it being able to man them. The suppliers are aware of this problem. Airbus has a training centre in Beijing and is setting up simulators elsewhere—as is Boeing. China is also allowing some private training schools to spring up, while China Southern already has its own training centre in Australia. But the shortage is acute and Chinese airlines are now talking of recruiting, reluctantly, pilots from overseas. Not only do they regard this as a blow to national pride; foreign crews also cost more.

Their weak profitability, coupled with ambitious plans to expand capacity, leaves the mainland carriers exposed to even a temporary slowdown in traffic growth. Further consolidation, allowing an attack on their structurally high costs, is one remedy. Another would be to liberalise the market for both fares and fuel. A braver step would be to let in foreign operators to boost competition. Finally, the oft-speculated three-way merger of Hong Kong's Cathay Pacific and Dragonair with Air China would create a world-class carrier and spread best practice. Whichever route the government chooses, it needs to act rapidly. After all, the industry has been hit by at least one major shock

every three years, from terrorist attacks to the SARS virus. After a couple of good years, the next bad one is due some time soon.

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Time Warner

Sweet surrender

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Carl Icahn has abandoned his plan to take control of Time Warner

JUST two weeks ago, Carl Icahn, a corporate raider, was in full swing at a presentation to investors, accusing Richard Parsons, chief executive of the world's biggest media company, of clinging to his fancy head-office building in Manhattan like Colonel Nicholson defending his bridge in the film “The Bridge on the River Kwai”. It was the climax of a colourful six-month campaign to break up Time Warner and oust Mr Parsons. Then last week Mr Icahn suddenly settled with the firm.

Who won? The answer, unusually, is both men, and the company too. Mr Parsons can take credit for calmly holding off one of America's most ruthless shareholder activists. But Mr Icahn has wrung meaningful concessions from Time Warner. The firm had planned to buy back $5 billion of its shares and now it has agreed to lift that to $20 billion by the end of 2007, which will boost its return to shareholders. Time Warner will also appoint two new independent directors to its board in consultation with Mr Icahn, and it will cut $500m more in costs than it had planned. Mr Icahn has also got the company's managers thinking harder about ways to lift its share price, which has fallen by 7% since Mr Parsons took over as boss in 2002.

The main reason why Mr Icahn abandoned his plan to wage a proxy fight is that he and his supporters hold only 5.67% of Time Warner's shares and he did not think he could win. His analysis of the company was in some respects correct. Many of its problems stem from its disastrous merger in 2000 with AOL, an internet-access firm. But Mr Icahn's drastic final recommendation—that Time Warner break itself into four pieces—failed to get the backing of other big shareholders.

Time Warner's four divisions—film and cable networks, cable distribution, publishing and AOL—have not worked closely together in the past. But Mr Parsons is now trying harder to extract more “synergy”. He also argues that it is unclear what the media industry will look like in future because of the way the internet and other digital technologies are altering things—hence it would be premature to start ditching key assets now. Separating AOL from Time Warner's film, television and publishing divisions, just as rival content companies are rushing to build audiences on the internet, would also be a mistake, some analysts reckon.

Nonetheless, says Peter Kreisky, a media consultant, “Icahn delivered a healthy jolt to Time Warner, and got it out of a rut.” During his campaign, Mr Parsons promoted Jeff Bewkes, the man who built HBO, its pay-TV business, to be heir-apparent, signalling that Time Warner has plenty of energy and talent at the top. In December Time Warner struck a deal with Google, which agreed to pay $1 billion for 5% of AOL, to which many analysts once ascribed a value of approximately zero. A short while earlier, Steve Case, the man who persuaded Time Warner to merge with AOL, resigned from the board, satisfying another of Mr Icahn's complaints.

A big reason why Time Warner's shares have languished is that investors are frightened that all of the traditional media will be swept aside by new technology. Shares in its competitors have also performed badly. The most pressing job now for Mr Parsons and Mr Bewkes is to position Time Warner to cope with the internet. The firm's recent dose of shareholder activism should have fortified it for the task.

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The video-games industry

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The transition to the next generation of consoles is proving tricky, as usual

ANYONE who plays video games will be familiar with the periodic delays that occur when one level has been completed and the next is loading. A similar delay is now affecting the entire video-games industry, as it negotiates the transition from the current generation of games consoles (Sony's PlayStation 2, Microsoft's Xbox and Nintendo's GameCube) to the next generation (the PlayStation 3, Xbox 360 and Revolution, respectively). Sales of current consoles, and the games that run on them, are slowing. Software companies are developing titles for the new consoles, which means fewer for today's machines. Consumers are spending less as they prepare to upgrade to fancy new hardware. “The transition blues will likely last throughout 2006,” grumbled a recent report from Susquehanna Financial, a bank.

This week, much disquiet greeted a Merrill Lynch report which suggested that Sony might have to delay the launch of the PlayStation 3 by as much as a year, and that each console would cost the firm $900 to build. Sony's shares fell over 6% in response, although they have since rebounded a bit. The company insisted that the PlayStation 3's “spring 2006” Japanese launch date remained unchanged, and other analysts questioned the accuracy of Merrill Lynch's figures. But a serious delay would be bad news for Sony, and—since it would prolong the transition to the next generation—for the $33-billion video-games industry as a whole.

Sony is betting on the technologically ambitious PlayStation 3 to do more than just continue its profitable dominance of the games industry. (The PlayStation 2, the clear winner in the current cycle with sales of over 100m units and a market share of around 70%, has sustained the company in recent years.) That is because the new machine will include a Blu-ray drive, capable of high-definition movie playback.

Blu-ray is currently locked in a standards war with a rival high-definition disc format, HD-DVD, backed by Toshiba. Billions of dollars in future licence fees are at stake as the two formats fight to establish themselves as the high-definition successor to the DVD format. But Sony, as the leader of the Blu-ray camp, hopes the PlayStation 3 will ensure victory by putting Blu-ray players into millions of homes. This will provide a large installed base and make Hollywood studios, which are expected to determine the outcome of the standards war, keener to back Blu-ray.

Most observers expect the console to go on sale in Japan in May, in the autumn in America and early next year in Europe. Any significant delay to this schedule could undermine Sony's cunning plan. The company could also lose market share to Microsoft, which launched its Xbox 360 last November. But Sony's main battle is, in fact, with Toshiba, says Michael Pachter, an analyst at Wedbush Morgan Securities. “Everything they are doing is geared towards having the greatest first-mover advantage against Toshiba,” he says.

Even so, a delay to the PlayStation 3 would also have repercussions across the video-games industry. The transition from one generation of consoles to the next is always painful, though this time around the launch of new portable game devices by Sony and Nintendo has helped to prop up software sales and mask the decline in sales of games for fixed consoles. But it is still a tricky period for software companies, notes Chris Kwak of Susquehanna. Two of the biggest, Electronic Arts and Activision, have announced weak results and layoffs in recent weeks; this week Electronic Arts cut some prices to boost sales.

The longer the transition to the next generation takes, the longer the industry will have to wait before things pick up again. Sales of games in America fell by 5% in January, according to figures from NPD, a market-research firm. Double-digit declines are likely over the coming months, says Mr Pachter. All this doom and gloom may lead some people to conclude that video gaming is in secular decline. That would probably be wrong: gaming has made great strides towards mainstream acceptance in recent years, and the current transition is, in fact, milder than previous examples. In short, the industry's current woes are a pause in the action, rather than the end of the game.

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American media

Trashy magazines junked!

Feb 23rd 2006 | NEW YORK
From The Economist print edition

A limitless appetite for nothing may have been sated at last

ptpx

Junk or genius?

THEIR headlines are as captivating as ever: “Jessica & Jude Steamy Hotel Romp!” (the *Star*); “Hillary Attacks Bill's Secret Lover” (*Globe*); “Farrah Fawcett: My Drug Hell!” (*National Enquirer*); and, most thrilling of all, “Giant polar monster attacks cruise ship!” and “10 New Commandments Found!” (*Weekly World News*).

Viewed in a vacuum, American Media, the owner of these publications, has never been more on its game, producing all the flotsam one could ever wish to know, and that ever-important little bit more. Behind the gloss, as it might say, lurks a darker picture. If these publications had business pages, the headline might read “Investors Pelted by Crumbling Bonds!”. Paddy Hirsch of Standard & Poor's points out that since early February the yield on the group's debt has risen to a junkier-than-junk level of 14%, up from a pristine 4.3% a year ago.

Collectively, American Media continues to sell millions of copies, but the numbers are contracting. The *National Enquirer* lost more than 20% of its circulation between 2003 and the middle of last year. Stricter industry standards for measuring circulation numbers are expected to push down reported sales further, for at least half of the group's publications when the new numbers are released in June. On February 15th, American Media announced it would restate financial returns dating back to March of 2004.

Meanwhile, sales of the *Star*, American Media's flagship publication, have been, “soft” recently, the company acknowledged, though it claimed that they have rebounded. Advertising is lagging as well. Given the magnetic quality of American Media's mastery of low culture, what could be going wrong?

Based on *The Economist*'s investigative trip to a news-stand, a possible conclusion is that the industry now faces the consequences of its own genius. Half-a-dozen publications now use exclamation marks on their covers to describe the divorces, pregnancies, affairs, eating disorders and assorted depravities of the same small group of celebrities—notably Jessica Simpson, Britney Spears, “TomKat” (Tom Cruise and Katie Holmes), Jennifer Aniston and, most important, Angelina Jolie and her “bump”.

The formula for filling out the rest of these publications has been standardised: spotting cellulite, tracking breast augmentation and all around liposuction; a smattering of scoops bought from gossipy make-up artists and bouncers, etc; and a bit of slavish grovelling in the “exclusive interview”. For a while, these magazines grew as a response to the fully airbrushed portraits in glossier establishments such as *Vogue* and *Vanity Fair*. But demand may at last be sated. On current trends, the number of magazines could soon exceed the number of celebrities they feature.

Worse still, price competition has entered the business. *In Touch* and *OK!* have both been introduced recently with cover prices of $1.99, compared with the prevailing $3 and above. People want their cheap thrills, but more cheaply.

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European utilities

Bidding and competing

Feb 23rd 2006
From The Economist print edition

Will more consolidation of Europe's utilities sector follow E.ON's bid for Endesa?

AFP

An image that needs polishing

IT IS the biggest takeover bid in the history of the utilities industry—and it may be just the beginning. On February 21st Germany's biggest power group, E.ON, bid €29.1 billion ($34.7 billion) to take over Endesa, a Spanish electricity giant. E.ON's move may signal the start of a long-awaited consolidation, in which four or five big players come to dominate the entire European energy utility market.

Since E.ON was created in 2000 through the merger of Veba and Viag, two German energy firms, the group has hoovered up companies big and small. It bought Britain's Powergen in 2002 and Ruhrgas, Germany's leading gas company, the year after that, as well as a host of smaller companies in northern and central Europe. After talks with Scottish Power broke down last November because the British energy group rejected E.ON's takeover offer, Wulf Bernotat, boss of E.ON, started to plot his big coup: a takeover of Endesa, which would make E.ON the world's largest electricity and gas firm, with more than 50m customers in more than 30 countries. He approached Endesa for the first time on December 1st.

Mr Bernotat's all-cash offer for Endesa is bigger and better than an earlier €21 billion cash-and-shares offer by Gas Natural, another Spanish utility. E.ON can afford such a splash. On the day of the bid's launch the firm reported a 71% jump in net profit from €4.3 billion to €7.4 billion. Yet Endesa's bosses reacted coolly to their German suitor: they think their company is worth more. The Spanish government is even less happy about a bid it sees as unwelcome. It had backed Gas Natural's offer, despite its rejection by Spanish antitrust authorities, in the hope of creating a national energy champion.

Mr Bernotat knows that he is stepping into a political hornets' nest, involving bitter political and regional rivalries within Spain. “We don't want to get involved in politics and we expect market rules to be applied,” he says. The Spanish government could use its shares in Endesa to block the German bid. But it will probably refrain. Spain would lose many friends within Europe by acting that way, at a time when Spanish companies are launching big cross-border raids, such as the bid by Ferrovial, a Spanish construction company, to buy BAA, owner of Heathrow, Europe's busiest airport; or Telefónica's bid for O2, a British mobile-phone operator.

The European Union's competition watchdog is likely to approve the bid too, since there is hardly any geographical overlap between E.ON and Endesa. E.ON's bid does, however, pose a dilemma for Neelie Kroes, the competition commissioner, because it runs counter to her efforts to increase competition in European energy markets. On February 16th Ms Kroes warned energy companies they could face tough antitrust penalties for squeezing out competitors and keeping prices unreasonably high.

Ms Kroes is putting more pressure on the big companies because the EU's deadline of July 2007 for full liberalisation of European energy markets is approaching fast. Last year companies started to position themselves for a genuine single market through a series of takeover bids. Suez, a French water and power company, took over

the 49.9% of Electrabel, a Belgian electricity company, it did not already own. And France's Electricité de France (EDF) and AEM, the power supplier for the city of Milan, took over Edison, the second-biggest Italian energy firm.

E.ON's bid for Endesa is putting more pressure on the group's rivals to grow. Like E.ON and RWE, the other big German energy group, EDF and Italy's Enel cannot grow at home without running into trouble with antitrust authorities. A day after E.ON's bid for Endesa was announced, Enel signalled that it wants to buy a stake in Electrabel, and may even launch a hostile bid for Suez itself.

If no rival to his own bid emerges, Mr Bernotat hopes the deal will be done by the summer. But Gas Natural is not giving up—it is talking of upping its bid. However, this is probably an empty threat. Gas Natural is half the size of Endesa and stretched its financial fire-power to the limit with last year's bid. Ultimately E.ON, EDF and Enel are likely to be among the handful of dominant utility companies in Europe. “We can see a second wave of consolidation of the industry coming,” predicts Mr Bernotat.

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Face value

Staying pure

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Reuters

Howard Schultz's formula for Starbucks

SOME people might want a “double tall skinny hazelnut decaf latte”, but Howard Schultz is not one of them. The chairman and “chief global strategist” of the Starbucks coffee chain prefers a Sumatra roast with no milk, no sugar and poured from a French press—the kind of pure coffee, in fact, favoured by those coffee snobs who sneer at Starbucks, not just for its bewildering variety of choice and flavours (55,000 different drinks, by the company's count), but for its very ubiquity—over 10,500 locations around the world, increasing at a rate of five a day, and often within sight of each other.

Starbucks knows it cannot ignore its critics. Anti-globalisation protesters have occasionally trashed its coffee shops; posh neighbourhoods in San Francisco and London have resisted the opening of new branches; and the company is a favourite target of internet critics, on sites like www.ihatestarbucks.com. Mr Schultz is watchful, but relaxed: “We have to be extremely mindful and sensitive of the public's view of things...Thus far, we've done a pretty good job.” Certainly, as reviled icons of American capitalism go, Starbucks is distinctly second division compared with big leaguers like, say, McDonald's.

The reason, argues Mr Schultz, is that the company has retained a “passion” for coffee and a “sense of humanity”. Starbucks buys expensive beans and pays its growers—be they in Guatemala or Ethiopia—an average of 23% above the market price. A similar benevolence applies to company employees. Where other corporations seek to unload the burden of employee benefits, Starbucks gives all American employees working at least 20 hours a week a package that includes stock options (“Bean Stock”) and comprehensive health insurance.

For Mr Schultz, raised in a Brooklyn public-housing project, this health insurance—which now costs Starbucks more each year than coffee—is a moral obligation. At the age of seven, he came home to find his father, a lorry-driver, in a plaster cast, having slipped and broken an ankle. No insurance, no compensation and now no job.

Hence what amounts to a personal crusade. Most of America's corporate chiefs steer clear of the sensitive topic of health-care reform. Not Mr Schultz. He makes speeches, lobbies politicians and has even hosted a commercial-free hour of television, arguing for reform of a system that he thinks is simultaneously socially unjust and a burden on corporate America. Meanwhile the company pays its workers' premiums, even as each year they rise by double-digit percentages. The goal has always been “to build the sort of company that my father was never able to work for.” By this he means a company that “remains small even as it gets big”, treating its workers as individuals. Starbucks is not alone in its emphasis on “social responsibility”, but the other firms Mr Schultz cites off the top of his head—Timberland, Patagonia, Whole Foods—are much smaller than Starbucks, which has 100,000 employees and 35m customers.

Why size matters

Indeed, size has been an issue from the beginning. Starbucks, named after the first mate in Herman Melville's “Moby Dick”, was created in 1971 in Seattle's Pike Place Market by three hippie-ish coffee enthusiasts. Mr Schultz, whose first “decent cup of coffee” was in 1979, joined the company only in 1982—and then left it in 1985 after the founding trio, preferring to stay small, took fright at his vision of the future. Inspired by a visit to Milan in 1983, he had envisaged a chain of coffee bars where customers would chat over their espressos and cappuccinos. Following his dream, Mr Schultz set up a company he called “Il Giornale”, which grew to a modest three coffee bars. Then, somehow scraping together $3.8m (“I didn't have a dime to my name”), he bought Starbucks from its founders in 1987.

Reality long ago surpassed the dream. Since Starbucks went public in 1992, its stock has soared by some 6,400%. The company is now in 37 different countries. China, which has over 200 stores, will eventually be its biggest market after America, and Russia, Brazil and India are all in line to be colonised over the next three years. The long-term goal is to double the number of American outlets to 15,000—not least by opening coffee shops along highways—and to have an equal number abroad.

No doubt the coffee snobs will blanch at the prospect. Yet they miss three points. The first is that, thanks to Starbucks, today's Americans are no longer condemned to drink the insipid, over-percolated brew that their parents endured. The second, less recognised, is that because Starbucks has created a mass taste for good coffee, small, family-owned coffee houses have also prospered (and no one has ever accused Starbucks, with its $4 lattes, of undercutting the competition).

The most important point, however, is that Mr Schultz's Starbucks cultivates a relationship with its customers. Its stores sell carefully selected (no hip-hop, but plenty of world music and jazz) CD-compilations, such as Ray Charles's “Genius Loves Company”. Later this year the company will promote a new film, “Akeelah and the Bee”, and will take a share of the profits. There are plans to promote books. Customers can even pay with their Starbucks “Duetto” Visa card.

Short of some health scare that would bracket coffee with nicotine, there is no obvious reason why Starbucks should trip up, however ambitious its plans and however misconceived the occasional project (a magazine called “Joe” flopped after three issues, and the Mazagran soft drink, developed with Pepsi, was also a failure). Mr Schultz says: “I think we have the licence from our customers to do more.” The key is that each Starbucks coffee house should remain “a third place”, between home and work, fulfilling the same role as those Italian coffee houses that so inspired him 23 years ago.

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Italian textiles and China

Material fitness

Feb 23rd 2006 | BIELLA, CARPI AND MILAN
From The Economist print edition

ROPI

How Europe's leading home for makers of clothing and shoes is adapting to low-cost competition from China

THINK of an Italian mid-market clothing brand with global presence, and the chances are you might think of Benetton, based near Treviso. Fifteen years ago, almost 90% of Benetton's colourful clothes were produced in its home market. Today Italian makers supply less than 30% and this will fall to 10% over the next few years. Benetton opened an office in Hong Kong early last year, partly in order to keep an eye on the Chinese suppliers upon whom it increasingly relies.

This is the harsh reality of competition in the global textiles and clothing industry. Last year marked the emergence of China as its dominant force. Only tariffs had kept it at bay before then, and threats of trade wars quickly led to some of them being renewed. This week, Peter Mandelson, Europe's trade commissioner, added shoes to his possible list for new tariffs. But no one should be fooled by such measures. It is only a matter of time before China's low labour costs and growing production skills crush competitors in western economies.

Nowhere is that threat more potent than in Italy. For generations its economy has relied on dense networks of firms, most of them small and middling family concerns, that clustered together and created wealth by mid-level manufacturing of goods such as clothing and shoes. They supplied not just the high-end fashion labels and designers, but also used the “Made in Italy” tag as a powerful marketing tool. Their success led to attention from economists such as Michael Porter, who noted the role of clusters and promoted them elsewhere as a way to jump start stalled or fledgling economies.

Today the impact of Chinese competition is becoming clearer. A long-term decline that saw the gradual erosion of jobs has accelerated, harming the economy. Italy has almost 600,000 jobs in textiles and clothing, about one-third of the sector's total in the old 15-country European Union and one-quarter of it in the enlarged, 25-nation, European club. The sector has been a major exporter and the generator of a large positive contribution to Italy's trading account. Both employment and that financial contribution are now declining.

More specifically, the textiles, clothing and footwear industries are dividing, as competition brings out the best in some companies and others fail to adapt. The best have ripped up their business models and ruthlessly shifted production to wherever it makes sense—some in eastern Europe, others in China itself—in order to concentrate on strengths such as design and marketing where the Chinese can be matched or beaten. Others are struggling to stay alive. Competition from China has also revealed a stark difference between the interests of Italian brand owners, who see a market opportunity for buying and selling, and many manufacturers, who feel threatened as their mainly domestic customers abandon them.

The process is raising doubts about whether the Italian economic model, once seen as robust and effective, was in fact much more vulnerable than it appeared. Far from being an advantage, it seems that it might actually be risky to be part of a cluster where survival depends in part on others to respond to threats in kind. And family firms,

though in theory as flexible as any, are not necessarily nimble in practice. Generational conflicts that once mattered little can prove fatal when speed and decisiveness are needed.

A good place to see the impact of competition from China is around the towns of Busto Arsizio and Gallarate, best known today for Malpensa, a sprawling international airport near Milan through which the fashion industry flocks for regular trade fairs at the recently completed fairground. For decades before the airport arrived cotton was the business around which the towns' economies turned.

Busto Arsizio and Gallarate were the centre of an industrial cluster in Varese province, so successful that it was known as the Manchester of Italy. But the number of workers in textiles and clothing in Varese province almost halved to 27,300 between the censuses of 1981 and 2001, and the number of firms employing them dropped from 4,900 to 2,900. Another 440 firms have closed since 2001. In the neighbouring province of Como, a once great silk cluster has shrunk by almost half.

Evidence of decline also scars valleys of the Alpine foothills about 50km west, in the wool cluster centred on Biella. Across the Po Valley in north-eastern Italy, the gates of Lanerossi's huge wool mill in Schio shut for the last time at the end of August 2005, ending almost two centuries of activity; 30 years ago the firm employed 7,000 workers. Times are hard, and getting harder, in every part of Italy where yarn is spun, textiles woven and clothing made.

The reason is that cheap, good quality imports, many from China, are taking market share. A research paper published last September shows that the slice of domestic demand taken by imports of textiles and clothing into Italy has risen from less than 20% in 1991 to almost 50%.

Italy's textiles and clothing makers are not alone in their troubles, or in causing increasing worry to policy makers. The “Made in Italy” label has been losing ground in footwear too. In 2004 the footwear industry, for long an export-leader, was overtaken; the number of shoes that left Italy for foreign markets was less than the number that Italy imported. Like firms in textiles and clothing, shoemakers have also cut jobs, from 124,200 in 1995 to around 100,000 last year. During 2005 more than 8,000 jobs were lost in firms making leather products. Many businesses have closed. Almost 8,900 firms made footwear ten years ago. Today there are fewer than 7,000.

Rossano Soldini, chairman of Associazione Nazionale Calzaturifici Italiani (ANCI, the footwear-makers' association), complains about the unacceptable disparities of competition and blames China for the sector's difficulties. He believes that the efficiency and productivity of Italian footwear firms are not part of the problem. Neither is the fragmentation that goes with reliance of Italian manufacturing on small and medium-sized family firms.

But these latter points are questionable. The family firm, apparently flexible, committed to investment and loyally carried forward by successive generations, has been widely reckoned a strength of Italian industry. But too many of them lack the scale they need to survive in tougher markets. The census in 2001 showed that textile firms in Varese province employed just 12 workers on average, while clothing firms employed half that number. Micro and mini-firms abound in Prato, 85% of them employing fewer than nine workers and only 1% more than 50. Italian footwear firms employ just 14 workers on average.

Reuters

Specialisation, in which a firm does only one phase of the manufacturing cycle, partly explains this fragmentation. But the desire for independence and diffidence towards outsiders also work against concentration and consolidation. Whereas in previous decades these traits gave clusters advantages over the big industrial sprawl of competing western economies, these days the processes are too inefficient to be competitive in all but the highest-value segments. Franco Pantaleoni, a consultant with Tangelo, a sourcing company in Hong Kong, is especially critical of clusters. They have, he says, encouraged shortsightedness, the black economy and consumption, while discouraging education and failing to prepare firms for change.

By depending on a single industry, clusters have also left regions vulnerable to shifts in business power. Treviso's economy is diversified, however, and jobs are not yet an issue in Carpi, where neat industrial estates and the city's shops exude well being. As well as its airport, Varese province has a large engineering industry and is within easy reach of Milan. But with its reliance on wool, Biella is less fortunate. “None of my predecessors had to address the question of unemployment,” says Vittorio Barazzotto, Biella's mayor.

“Nowadays, small but beautiful really means tired,” remarks Giovanni Burani, chief executive of Mariella Burani Fashion Group. He believes that small and medium-sized independent firms need to grow, but have no room for error while they try to do so. His group's listing on Milan's stock exchange in 2000 provided cash for a strategy of growth through acquisitions of clothing and accessories brands and licences, and turnover has since risen almost threefold.

There may be room for some niches to survive. The cluster around Stra, between Venice and Padua, makes luxury shoes that retail at around $400 a pair in America. Some 350 craft workshops there, employing 8,000 people, deliver about 20m pairs of shoes a year to global fashion brands such as Chanel, Christian Dior and Givenchy. They have no complaints about the state of business at the moment. But even these craftsmen may be living on borrowed time.

Some firms have given up manufacturing and turned to adding value through design and research and development. Carlo Rivetti is one example. In the early 1980s he established C.P. Company, a sports and casual-wear design firm, near Carpi. “We are not fashion, but design, closer to Pininfarina (a high-end car-design boutique) or Ferrari than Fiat,” he says. Research into materials such as Kevlar, optical fibre and steel is at the heart of the business.

Yet there cannot be a niche for everyone and, niches apart, the survival of Italy's footwear, textiles and clothing companies depends on them getting their strategies right across four main factors: brands; market positioning; exporting; and careful buying for price and quality.

Plenty of firms are clinging on, even prospering, by milking and developing already established brands. For example, Ermenegildo Zegna, based near Biella, shows little fear for its future. Known for its classy men's suits, the firm has a strong brand. It was among the vanguard of global brands entering China, making its first downstream investments in 1991, says Ermenegildo Zegna, grandson of the firm's founder and its joint head. They now have retail outlets in 24 cities there. The group is vertically integrated and manufactures mainly in Italy, which it claims has not been a problem so far.

Still, just, made in Italy

Others have also clung to local manufacturers by positioning themselves cleverly in the market and by systematically building the trading links that underpin their exports. Mariella Burani, which makes 70% of its sales abroad, outsources all of its production, about 70% to Italian firms. Another Carpi firm, that owns the luxury brands Blumarine and Anna Molinari, uses local manufacturers.

Many mid-market brands have already moved almost all of their production abroad. Only 10% of the sportswear sold by Carpi-based Navigare is made in Italy. Most of the garments are made in the firm's own factory in Bulgaria or elsewhere in eastern Europe. Sauro Mambrini, head of Champion Europe, a global brand in sportswear whose head office is in Carpi, notes that its suppliers migrated from Italy to eastern Europe at the end of the 1980s, to Turkey a few years later and in the second half of the 1990s to the Far East. Champion Europe's supply office in Singapore now buys 30% of the firm's needs. The same trend is true in footwear.

Romania has been a magnet for Italian businessmen, particularly those based in the north-east. Thanks to geography, and monthly unit labour costs of around €250 ($298) against a minimum of €2,000 at home, Italians own about 1,500 textiles and clothing factories and 1,000 footwear factories in Romania and employ around 200,000 people there. As pressure from China increases in the coming years, even these operations are likely to find it an ever harder struggle to survive.

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Companies' and countries' prosperity

Decoupled

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Ronald Grant

The health of companies and the wealth of economies no longer go together

“NOTHING contributes so much to the prosperity and happiness of a country as high profits,” said David Ricardo, a British economist, in the early 19th century. Today, however, corporate profits are booming in economies, such as Germany's, which have been stagnating. And virtually everywhere, even as profits surge, workers' real incomes have been flat or even falling. In other words, the old relationship between corporate and national prosperity has broken down.

This observation has two sides to it. First, as Stephen King and Janet Henry, of the HSBC bank, point out, companies are no longer tied to the economic conditions and policies of the countries in which they are listed. Firms in Europe are delivering handsome profits that are more in line with the performance of the robust global economy than with that of their sclerotic homelands. In the past two years, the earnings per share of big listed companies have climbed by over 100% in Germany, 50% in France, 70% in Japan and 35% in America. No wonder Europe's and Japan's stockmarkets have outpaced those in America, despite the latter's faster GDP growth.

Second and more worrying, the success of companies no longer guarantees the prosperity of domestic economies or, more particularly, of domestic workers. Fatter profits are supposed to encourage firms to invest more, to offer higher wages and to hire more workers. Yet even though profits' share of national income in the G7 economies is close to an all-time high, corporate investment has been unusually weak in recent years. Companies have been reluctant to increase hiring or wages by as much as in previous recoveries. In America, a bigger slice of the increase in national income has gone to profits than in any recovery since 1945.

Home truths

The main reason why the health of companies and economies have become detached is that big firms have become more international. The world's 40 biggest multinationals now employ, on average, 55% of their workforces in foreign countries and earn 59% of their revenues abroad. According to an analysis by Patrick Artus, chief economist of IXIS, a French investment bank, only 53% of the staff of companies in the DAX 30 stockmarket index are based in Germany; and only one-third of those firms' total turnover comes from there. Only 43% of all the jobs at companies in France's CAC 40 are in France. With the profits of these firms so dependent on their global operations, it is not surprising that corporate prosperity has failed to spur “home” economies.

American and Japanese companies remain more closely tied to their domestic markets. Just one-fifth of the turnover of firms in Japan's Nikkei index comes from overseas. Foreign sales of America's S&P 500 companies amount to a modest 25% of the total. Even so, at the 50 biggest firms the figure is higher, at around 40%. The old

saying, “What's good for General Motors is good for America”, no longer rings true: over one-third of GM's employees work outside the group's home country.

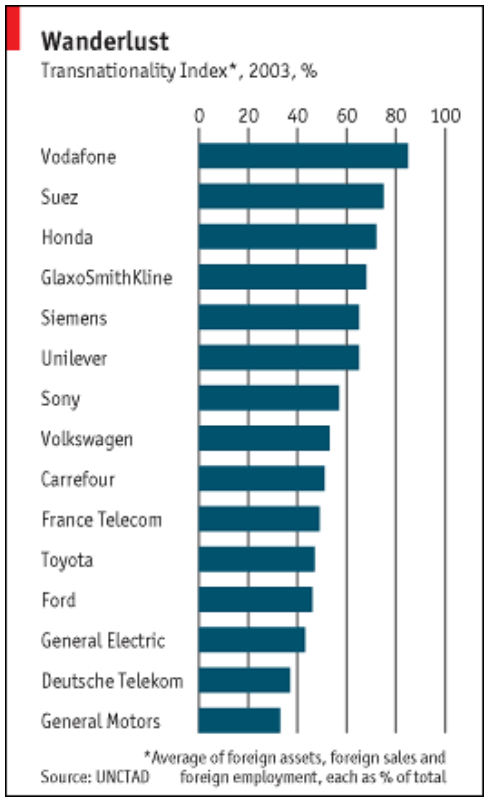
If a large part of the spurt in profits comes from foreign operations, it is less likely to be used to finance investment or extra job creation at home. If they reason that the recent past is a fair guide to the immediate future, companies are likely to plough their extra profit into further investment abroad. Alternatively, they may buy back shares or repay debt.

Globalisation has also shifted the balance of power in the labour market in favour of companies. It gives firms access to cheap labour abroad; and the threat that they will shift more production offshore also helps to keep a lid on wages at home. This is one reason why, despite record profits, real wages in Germany have fallen over the past two years. That in turn has depressed domestic spending and hence GDP growth.

Workers can still gain from rising profits if they own shares, either directly or through pension funds. There is reason to think that the share prices of large listed companies will fare better than their home economies. Economic theory and historical experience argue that, in the long run, profits grow at the same pace as GDP. However, if the profits of big companies are increasingly linked to global production, then the profits of listed companies in developed economies could rise faster than domestic GDP for many years.

In America, capital gains on shares have played a big role in supporting household spending over the past decade. But Mr Artus worries that workers in continental Europe are losing out, because a surprisingly high proportion of shares are held by foreigners: as much as 35% in France and 16% in Germany. This is partly because of the smaller role played by institutional investors, such as pension funds, in Europe compared with, say, America.

If profits (and hence executive pay) continue on their merry way, while ordinary employees' real wages stand still and their health benefits and pensions are eroded, workers might well expect their governments to do something to close the gap. It's not hard to think of ideas that would be popular—higher taxes on profits, restrictions on overseas investment, import barriers, or making it harder to lay off workers. The trouble is, in a globalised economy such measures would also be suicidal. Firms would simply move operations' head offices to friendlier countries.



A more promising way of allowing workers to share in companies' prosperity is to encourage firms to introduce profit-sharing schemes for employees. But perhaps the most useful thing that governments can do is to ensure that consumers (ie, workers) benefit from lower prices as a result of the shifting of production to low-cost countries. The prices of consumer goods have fallen by much more in America in recent years than in the euro area, where retailers are shielded from competition and have not passed on cost reductions. Greater competition in Europe would allow workers to share in the gains of globalisation through lower prices.

The clear lesson is that policies aimed at penalising companies will fail to spread the rewards of corporate success to the wider economy. The only sure way to boost national economic prosperity is to make labour and product markets work more efficiently and to improve education, to make the home country a more attractive production base.

The growing internationalisation of companies also makes a nonsense of the paranoia, in both America and Europe, about foreigners buying “our” companies. It has always been foolish for governments to block foreign takeovers which make good economic sense. It is even more so today. When over half of the workforce of many big companies is based abroad, the distinction between foreign and domestic firms has become increasingly blurred. There was patriotic outrage in France at the hostile bid for Arcelor by Mittal, a global steel giant. Yet although Arcelor is a member of the CAC 40 and viewed in France as a national corporate jewel, it is actually the product of a three-way European merger. It is incorporated in Luxembourg and only one-third of its employees are in France. In future the notion of “our” companies will become even more elusive.

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Financial exchanges

The Australians fold their tents

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Europe's exchanges cannot afford to relax, despite Macquarie Bank's defeat

MACQUARIE BANK, an acquisitive Australian institution that dared to tilt at the London Stock Exchange (LSE), may be feeling a little bruised, having in effect withdrawn its bid this week. But it is possible that history will judge Macquarie more kindly than its detractors do today. Its bid pushed the LSE into returning more cash to shareholders than it might have done otherwise, and more quickly. And it was not afraid to make the helpful observation that national exchanges share some characteristics with utilities.

Predictably, this analogy upset exchange executives in both London and continental Europe. The Australians were derided from the outset (they might run toll roads and airports, but what did they know about exchanges?) and their bid of 580 pence ($10.20) a share was left trailing by the market's increasingly bullish view of the LSE's worth (see chart). Their defeat also caused a few giggles at the expense of Goldman Sachs, its investment bank, which had also advised Deutsche Börse, a German exchange group, on its own failed bid for the LSE last year.

Yet this is no time for the managers of the LSE or its continental counterparts to relax. Demanding shareholders and users, as well as broader structural changes in the industry, are keeping their feet to the fire.

Deutsche Börse acknowledged as much on February 21st when it laid out a strategic plan that trebled its dividend, to €2.10 ($2.50) per share, and expressed qualified enthusiasm for marriage to another exchange. It now considers Euronext—a pan-European group that has also wooed the LSE—"by far the most attractive among a large number of relevant options". The two have discussed a tie-up in recent months, but talks became snagged on matters ranging from where the headquarters would be (the Germans favour Frankfurt, Euronext does not) to questions about clearing and settlement.

While Macquarie was not the first to note that exchanges throw off a tremendous amount of cash, its bid for the LSE reminded shareholders "how far you could leverage the balance sheet," says Andrew Mitchell of Fox-Pitt, Kelton, an investment bank. "Macquarie helped investors crystallise their thoughts." Last week the LSE said it would double the cash returned to shareholders. Deutsche Börse returned €800m in share buy-backs and dividends in 2005 and plans to return another €700m by May 2007. Euronext is also mulling a return of capital, and will unveil its plans on March 14th.

Exchange users, notably big investment banks, say that they too should benefit from growth, through lower fees. This week they met to urge Charlie McCreevy, the European Union's internal-market commissioner, to push for a more open cross-border system of clearing and settling share trades. Britain's competition authorities have already said that Deutsche Börse or Euronext must sell some clearing holdings if they want to pursue the LSE.

In the past, Mr McCreevy has favoured letting the market provide a solution on cross-border clearing and settlement, while noting that it remains costly and inefficient and puts "an unacceptably high burden on cross-border investment" in Europe. People who attended this week's meeting say that he may now consider issuing a directive if he finds the economic arguments persuasive. A decision is due in the second quarter. "I'm optimistic liberalisation is going to come about" in clearing and settlement, says Alberto Giovannini, who chairs a group of European financial-services firms. But, he adds, consolidation is likely to be "messy and choppy".

Not surprisingly, exchanges with their own clearing and settlement operations—notably Deutsche Börse and Euronext—are more resistant to regulatory intervention. Even so, Deutsche Börse this week sounded a bit more conciliatory than usual about various possible formats for a single European equities clearing operation. The exchanges may be loth to admit it, but a growing number of market observers think that such post-trade services are a bit like utilities, and perhaps should be run and regulated in the same way. A little like the Australian way of thinking?

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Asset management

The long and the short of it

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Mutual funds are borrowing hedge funds' techniques—and their fees

FOR many asset-management firms, hedge funds have long been like a maddening little brother: small, cocky, subject to fewer rules and, yes, the apple of everyone's eye. Family resemblances, however, will out. Mutual funds, while more tightly regulated than their boisterous siblings, are acquiring hedge funds and adopting some of their behaviour, such as the use of leverage, short-selling (betting on a price falling) and derivatives.

Ironically, they are doing this after a period in which hedge funds have struggled to beat pedestrian index-trackers. And lately some index-fund managers have been fighting a fee-cutting war. So is the aping of hedge funds just a wheeze to justify higher fees, or will clients, such as pension funds, benefit?

This week, Schroders, a British institution born in the era of Admiral Nelson, became the latest old-style fund manager to embrace the saucier end of the investment market. It agreed to buy NewFinance Capital, a London fund of hedge funds founded just four years ago, for up to $142m. The price was not considered steep by the market. Indeed, it was on a par with last year's acquisition by America's Legg Mason of Permal, a French fund of hedge funds: with a downpayment of $800m, that was the largest such takeover so far.

Next week Morningstar, an American company that tracks the performance of mutual funds, will create a new category for regulated institutions that invest in both long and short positions, a favourite hedge-fund style. Dan McNeela, an analyst with the firm, says that at first it will consist of two dozen funds with $7.6 billion under management. “It's a very small percentage of mutual funds that do any shorting at all, but it's definitely becoming more common.”

Other big fund managers, including State Street Global Advisors and Goldman Sachs Asset Management, have also devised ways to spice up the returns of even their most passive-sounding funds, by overlaying short-selling techniques on long-only portfolios. The idea baffles many pension-fund trustees, brought up on simpler choices such as equities versus bonds. But its champions claim it can raise their chances of beating their benchmarks, without much increasing risk.

Although it can still give regulators the willies, especially when combined with derivatives and gearing, short-selling is steadily gaining respectability. In America, mutual funds can sell short with some restrictions, for instance on leverage. In the European Union, recent changes in regulation allow fund managers to take short positions by using derivative instruments, such as contracts for difference and credit default swaps, rather than through underlying shares or bonds.

State Street and Goldman Sachs are developing funds that will enable them to short-sell exposure to companies they do not like in an index, rather than just underweighting them, as they do now. It is a common complaint of long-only funds that they can only underweight shares by at most their share of the benchmark. At the end of last year, only 49 stocks in the S&P 500 accounted for more than 0.5% of the index's total capitalisation and therefore could be underweighted by more than half a percentage point (see chart). Bigger stocks tend to be underweighted more often than smaller ones. This breeds inefficiency and concentrates risk.

State Street says it is trying to “loosen the handcuffs”. But neither it nor Goldman Sachs is planning a short-selling spree. Both institutions would limit short-selling to around 30% of a global portfolio, while keeping 130% long-only. They say the strategy offers a slice of outperformance, or “alpha” in hedge-fund-speak, on top of a benchmark or “beta” product. “Currently, if we really don't like a stock we can't do much about it, and we regard that as leaving alpha on the table,” says Lloyd Reynolds of Goldman Sachs Asset Management. “With the addition of shorting, we can underweight it more.”

Results have been unspectacular. A State Street fund that started using the technique in Australia last year has beaten its benchmark, but by less than it had hoped. Mr McNeela at Morningstar says the funds it will include in its “long/short” category have performed disappointingly. He puts this down to their higher fees and to the difficulties of beating a rising market.

Some traditional asset managers seem to believe they are entitled to charge hedge fund-like fees to manage hedge fund-like products. Others, such as State Street and Goldman Sachs, are developing more nuanced fee structures. They charge like a hedge fund only when they beat their benchmarks. That is generating interest among pension-fund clients, some of whom are eager for innovative and lucrative ideas. Only once the fund managers have proved their worth can they charge what they like.

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Gold and the Bundesbank

Self-inflicted wound

Feb 23rd 2006 | FRANKFURT
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Germany's central bank cuts off its nose to spite its face

A TRUCE was called last week in a battle between Germany's Bundesbank and federal government over the country's 3,400 tonnes of gold reserves. The central bank is proud of having stood up to the finance minister. However, it is hard to see what it has gained.

The gold is worth about €50 billion ($60 billion) according to the Bundesbank (valuing its stash at recent market prices). Every finance minister for the past two decades has been trying to coax the central bank into selling some. Although an agreement between central banks, sealed in 2004, would allow it to unload 120 tonnes a year until 2009, the Bundesbank won't budge.

Most Bundesbankers see themselves as custodians of the people's wealth. Selling some of it, especially to fill part of the gaping hole in the public finances, would both erode that wealth and damage the central bank's fiercely guarded independence. So when Peer Steinbrück, the new finance minister, proposed that the Bundesbank should keep the capital proceeds of any gold sales but that the interest should go to the budget, he was sent away with a flea in his ear. The Bundesbankers were especially miffed by a veiled threat that if they did not co-operate, their special pay supplement, which adds up to 19% to their basic salaries, would be removed.

The days when journalists would invariably describe the Bundesbank as “mighty” are long gone. With other euro-zone central banks, it handed monetary policy over to the European Central Bank when the euro was born in 1999. In the past four years the Bundesbank's staff has been reduced by over 20%, to 12,300. It will fall to 11,100 by the end of 2007. That is still too many for what is now merely one member, albeit the biggest, of the euro club. And its eight-man board is too big, a concession to regional politics. Nevertheless, it is a founding principle of the euro area that national central banks be independent of their governments. This gives Axel Weber, the Bundesbank's president, a strong hand in any disputes with ministers.

Although Mr Steinbrück was seen off, the Bundesbank looks a little ridiculous. Under last week's truce, Bundesbankers' supplement will be phased out, but gradually, to be replaced with increases in basic pay; the bank's top officials in Frankfurt will still get a 9% top-up. But under the existing Bundesbank law the proceeds of any gold sales go to the government anyway, as do all the central bank's profits. This week Mr Steinbrück unveiled a budget which foresees that €3 billion will come in from the Bundesbank this year. Meanwhile, one parliamentarian has proposed putting Mr Steinbrück's proposal into law anyway.

So, to spite Mr Steinbrück, the once-mighty Bundesbank has simply robbed itself of flexibility. It risks hoots of derision if it now sells an ounce of gold.

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Brazilian IPOs

New wave for the Novo Mercado

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A rash of listings and an outbreak of shareholder democracy

NATURA, a company that sells cosmetics door-to-door Avon-style, started the fashion. Its initial public offering (IPO) in May 2004 was the first in Brazil in more than two years. Since then, 18 companies have made their debuts on São Paulo's stockmarket, the Bovespa. Another score are expected to do so by the middle of this year. The newcomers are not only adding variety to a market ruled by banks, extractors of raw materials and state-owned companies; more important, they herald a change in Brazil's investment culture. Equities are gaining space in a market dominated by government bonds. And old-style corporate governance, in which holders of small financial stakes monopolise voting shares, is yielding to shareholder democracy, where an investment's size and its voting power go hand in hand.

The debutantes are exploiting a global and seemingly insatiable appetite for Brazilian securities. High-yielding bonds are the main attraction. Those denominated in *reais* got an extra boost last week when the government exempted foreign buyers from income tax. But equities, already popular (see chart), could become more so as domestic interest rates fall. In Brazil, just 17% of institutions' assets are held in equities, against 41% in Chile, notes Urban Larson, of the Baring Latin America Fund.

Bovespa's biggest stocks are a state-owned oil giant (Petrobras), a privatised minerals exporter (Vale do Rio Doce) and a bank (Bradesco), which together account for one-third of the market's capitalisation. The newcomers are mostly more glamorous, oriented to Brazilian consumers and traded on the Novo Mercado (new market), a democratic enclave within Bovespa that admits companies that issue only voting shares. Before Natura, just two enterprises traded there. Now 21 do, including DASA, a fast-growing chain of medical laboratories, Submarino, an internet retailer, and Gafisa, a home builder anticipating a boost from lower interest rates.

Such companies “are creating a new benchmark for corporate governance in Brazil,” says Cristiano Souza, of Dynamo Asset Management. Under Brazilian law, two-thirds of a company's equity can be in the form of non-voting preference shares, called PNs, so a financial stake of less than 17%—a majority of the ordinary shares (ONs)—can secure control. (A 2001 law, however, cut the maximum weight of PNs in new companies to 50% and thus, in effect, set the minimum controlling stake at 25% plus one share.) Traditionally, investors did not care, since the more-liquid PNs offer an easier exit in a turbulent market. But after a series of clashes with owners, PN holders now see the value of voting power. One dispute pits ON holders in Ripasa, a paper company, who received a big premium for selling the firm to two competitors, against PN investors, who did not.

Today, any company that does not list on the ON-only Novo Mercado needs a good excuse. One such is Gol, Latin America's first publicly traded low-cost airline, which is not allowed to sell control to foreigners. It listed on Bovespa's “level 2,” which requires “tag-along rights” in takeovers for PN investors and refers disputes to arbitrators rather than to Brazil's slow courts. Few would dare offer less. Companies on the Novo Mercado and level 2 are trading at nearly double the price of the rest as a multiple of expected 2006 earnings, says Mr Souza, although this partly reflects the sectors these companies are in.

They are spawning imitators. In January Embraer, Brazil's aircraft manufacturer, said it would list its Brazilian shares on the Novo Mercado. Rossi Residencial, a home builder, followed and Perdigão, a meat company, is set to be next. Increasingly, that is a first step towards dispersing control. So far just two companies on the Bovespa—Lojas Renner, a retailer, and Eternit, a building-materials firm—have no controlling shareholder. They will soon be joined by Submarino, DASA and Perdigão (plus Embraer, though the government will retain a takeover-busting golden share). Widely held companies are more vulnerable to hostile takeover bids—a spur to managers and a boon for shareholders.

Optimism may now be tipping into hubris. Earlier IPOs were at “big discounts to international peers,” says Mr Larson, but the most recent look expensive. Investidor Profissional, an asset manager that buys under-valued

shares, has no big investments in the recent wave of IPOs. It prefers neglected companies, some in dowdy sectors like textiles. After all the excitement, boring may become beautiful.

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Person-to-person finance

Bankless banking

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Borrowing and lending get personal

THE internet age was supposed to herald hard times for the middleman. Customers, so it was said, would flock to the web to buy products and services faster, cheaper and more transparently than in shops or through intermediaries. Disintermediation has indeed come about, as any out-of-work travel agent or bookseller will tell you. Yet retail bankers—the middlemen between savers and borrowers—have been surprisingly untouched.

Enter Prosper Marketplace, a Californian company that matches people who need small loans with others who have extra cash to lend. Prosper launched its website on February 6th. This week, the number of active bids for loans was running at around 200. Lenders have put up some $750,000.

Such "person-to-person" lending is not entirely new. Zopa, a British venture that also matches borrowers with willing lenders, opened for business last March. It now boasts 50,000 members, of whom 15% are actively trying to borrow or lend money at any given time. The company does not publish the volume of loans.

On both Zopa's and Prosper's sites, borrowers, who first undergo identity and credit checks, post bids specifying how much they wish to borrow and the highest interest rate they are willing to pay. Lenders bid the lowest rate they will accept for a given credit profile (based on credit scores, debt-to-income ratios and other metrics) and period. To diversify risk, most loans are made on a "one-to-many" basis, meaning a lender's loan of, say, $5,000 would be spread across lots of borrowers. Zopa's lenders' money is strewn among at least 50 borrowers; Prosper's members can take on entire loans if they like.

The companies manage repayments and hire debt collectors should a borrower default. They make their money by charging borrowers 1% of the amount of the loan. Prosper also charges delinquency fees and levies a servicing charge on lenders. Zopa takes commissions on repayment insurance.

Zopa and Prosper say that lenders can earn a higher rate than they would from a savings account and borrowers pay less than on a credit card. According to Richard Duvall, Zopa's chief executive, interest rates on Zopa have averaged 7% before bad debts (of which there have so far been none). That compares with the 4.5% paid on a good British savings account and the 15% typically charged on credit-card debts.

There is a psychic pay-off, too. Users on Zopa have said that they like lending and borrowing within a community of "real" people, rather than through a faceless bank. Mr Duvall notes that affinity credit cards (ie, those linked to an activity or membership) tend to have lower default rates than traditional credit cards. "The sense of community matters," he says.

Prosper takes this idea a step further, by allowing customers to form groups of borrowers with similar interests or backgrounds—similar to social networking sites such as MySpace.com or Friendster. Groups include one made up of Harvard Business School alumni, and others for atheists and agnostics. Groups with reputations for repaying loans on time can expect to get cheaper interest rates.

Chris Larsen, Prosper's founder, believes that these groups will help his company cut the two biggest costs encountered by credit-card companies: customer acquisition (often requiring pricey direct-mail or advertising campaigns) and defaults. Because group leaders earn money as their members repay loans, they have an incentive to recruit new members—in theory, doing Prosper's marketing for it. And the hope is that group members will be less prone to default because doing so would lower the credit rating of their group as a whole. Moreover, while borrowers can remain anonymous to the larger community, group leaders will know who has defaulted, so there is a "shame" factor. "It only takes lowering default rates by a fraction of a percentage point to make a difference," says Mr Larsen.

Catherine Graeber of Forrester Research, a consultancy, is intrigued by the idea, particularly because it might attract 18- to 28-year-olds who need credit and spend hours logged on to social networking sites. These people, says Forrester, are much less likely than their parents to care about brands when choosing a bank. They are also routinely ignored by banks.

Still, potential pitfalls remain. One is that Prospect's group concept suffers from an inherent conflict: bigger groups mean more borrowers, but less cohesion, weakening the shame factor. But perhaps person-to-person finance's biggest difficulty will be to attract enough lenders—particularly once customers start to default, as they surely will. Ms Graeber points out that there is a reason why banks and credit-card companies charge the rates they do. “Unsecured lending has a high default rate,” she says. “What do these companies know that banks don't?”

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Economics focus

Opening up the big box

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Measuring the Wal-Mart effect

Get article background

THE Clintons are only the second-biggest phenomenon to emerge from Arkansas. The Waltons, the founding family of Wal-Mart, opened their first store in the state in 1962. Wal-Mart now has 3,800 shops nationwide. The discount retailer is the world's biggest company by sales: a record $312.4 billion in the last fiscal year, according to figures released this week.

Wal-Mart has been quick to generate controversy, slower to attract serious study. In his engaging book, "The Wal-Mart Effect" (see article), Charles Fishman notes that he could read all of the significant academic papers on the company's impact on prices, jobs, suppliers and competitors in a couple of afternoons at the library. This was partly due to a "paucity of data", writes Emek Basker, an economist at the University of Missouri, whose requests for numbers from the company were denied. But Wal-Mart is now more forthcoming with figures. It commissioned its own study of the Wal-Mart effect from Global Insight, a research company, and held a conference on the subject last November*. Enough new studies are circulating to extend one's stint in the library by another afternoon at least.

America is home to more Wal-Mart employees (1.3m) than high-school teachers. A typical store is manned by 150-350 people; the bigger "supercentres", which sell groceries, employ 400-500. But even as Wal-Mart creates some jobs, it displaces others. What is the net effect? According to the company, "new businesses spring up near Wal-Marts and existing stores flourish as they take advantage of the increased customer flow to and from our stores." Global Insight reckons that a 100,000 square-foot (9,300 square-metre) Wal-Mart creates 97 retail jobs, after the dust has settled, but destroys 30 in wholesale. This is a happier finding than some of the retailer's critics would allege.

This result may, however, be flawed—for the familiar reason that correlation does not prove causation. Wal-Mart, after all, does not set up shop at random. All else equal, it is presumably attracted to relatively thriving retail markets, with robust sales and hence strong employment. Its entry into a neighbourhood may be the result, not the cause, of high retail employment there.

The Global Insight authors reckon this is a problem only in principle, not practice. Not so, argues another paper presented at the November conference, and since updated, by David Neumark, Junfu Zhang and Stephen Ciccarella, of the Public Policy Institute of California, a think-tank. Like Global Insight, they are interested in measuring the impact of one thing (exposure to Wal-Mart) on another (the health of local retailing). But unlike Global Insight, they use a proxy for the first variable that is not itself affected by the second.

That proxy is distance, measured in miles from Bentonville, the company's place of origin. Wal-Mart, they point out, spread like a "wave", rippling outwards from its Arkansas epicentre in a widening circle. It reached California only in 1990 and New England a year later. The greater a county's distance from Bentonville, the later Wal-Mart's arrival there, regardless of the county's retailing appeal.

The authors track Wal-Mart's progress through 3,032 counties from 1977 to 1995. The arrival of a store in a typical county destroys about 180-270 retail jobs, they conclude, which suggests that each Wal-Mart associate does the job of 1.5-1.75 people at a rival. However, this does not imply a rise in overall joblessness: those displaced by Wal-Mart will tend to find work elsewhere.

What about wages? Mr Neumark and his colleagues could not measure wages directly. But they did estimate Wal-Mart's impact on retail payrolls, which averaged $13,860 per worker in their sample. The opening of a Wal-Mart store reduces these by only about 1%. Whether this was because hours shorten, wages fall or low-paid jobs displace well-paid jobs, they could not tell.

The other side of the coin

Wal-Mart may shave payrolls, but it slashes shopping bills—even for people who never shop there. Ms Basker estimates that the prices of goods such as toothpaste, shampoo, aspirin and laundry detergent fall by 7-13% five years after Wal-Mart's arrival in a city. Some analysts think the company has to offer lower prices to compensate customers for a less pleasant shopping experience. Robert Gordon, of Northwestern University, describes how Europeans “recoil with distaste from the ubiquitous and cheerless American strip malls and big-box retailers”.

But such delicate sensibilities should not be imputed to everyone, argue Jerry Hausman, of the Massachusetts Institute of Technology, and Ephraim Leibtag, of America's Department of Agriculture, who study Wal-Mart's deep incursions into the grocery market. Yes, a shopper cares about where he shops, as well as what he buys. But they see the entry of Wal-Mart and similar retailers as akin to the introduction of a new good or brand. It gives consumers another option to ponder. Whether it is better, worse or just different they leave to consumers' choices to reveal.

Those choices do not show much recoiling. Supercentres claimed a growing share of household spending on groceries, from 10.9% in January 1998 to 16.9% in December 2001 (although planning and geographical constraints have probably begun to limit growth since then). Messrs Hausman and Leibtag reckon the existence of big-box retailers, such as Wal-Mart, is a substantial boon to shoppers—equivalent to offering households 25 cents back for every dollar they spend on groceries, or about $450 a year on average. Were the calculation repeated for other merchandise, the figure would be bigger still.

Some of Wal-Mart's detractors think it “cheerless”, others mean. But what Wal-Mart saves on its payrolls it passes on to consumers. There are two sides to every penny it pinches.

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*All the papers are available at: www.globalinsight.com/walmart

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Marjorie Deane internship

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Applications are invited for the 2006 Marjorie Deane internship. This award, financed by the Marjorie Deane Foundation, is designed to provide work experience for a promising journalist or would-be journalist, who will spend three months of the summer at *The Economist*, writing about finance. Applicants may also be considered, if they wish, for an internship of similar duration at *CFO Europe*, a sister publication of *The Economist*. Applicants should send a letter introducing themselves, with an original article of about 1,000 words that they think would be suitable for the finance and economics section of *The Economist*. Applications must reach us by March 31st. They should be e-mailed to deaneintern@economist.com or posted to the Business Affairs Editor (Deane internship), The Economist, 25 St James's Street, London, SW1A 1HG.

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Animal disease

The aves, and ave nots

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Avian influenza is spreading to many new countries. But migrating wild birds may not be the only culprits

RSPCA

IN AROUND a month, bird flu has appeared in a seemingly alarming number of new countries. The disease is already endemic in the poultry flocks of much of Asia. In the face of the relentless march of the H5N1 virus around the world, fatalism is not an appropriate response. Better to look at exactly what is going on.

The arrival of bird flu in Europe and its neighbourhood has caused most of the flap, yet the cases in Azerbaijan, Bulgaria, Greece, Italy, Slovenia, Iran, Austria, Germany, France, Hungary and Croatia are only in wild birds. In Nigeria, Egypt and India, the virus has been discovered to be widely distributed across poultry flocks.

While the presence of the virus in any form is a concern, Nigeria, Egypt and India face bigger problems coping with dense farmed avian populations, and they are less well equipped to deal with them. More significantly, it is increasingly apparent that the real and most immediate issue is to what extent wild birds, or humans themselves, are responsible for the infection's spread in poultry.

A research paper in *Proceedings of the National Academy of Sciences*, published online on February 10th, shows that the H5N1 virus has persisted in its birthplace, southern China, for almost ten years and has been introduced into Vietnam on at least three occasions, and to Indonesia. The authors suggest that such transmissions are perpetuated mainly by the movement of poultry and poultry products, rather than by migrating birds.

This is significant because it strongly supports bird conservationists, who have been arguing that most outbreaks in South-East Asia can be linked to movements of poultry and poultry products, or infected material from poultry farms, such as mud on vehicles or people's shoes. Conservationists also argue that live animal markets have played an important role in the H5N1's spread. Such markets were the source of the first known outbreak in Hong Kong in 1997 when 20% of the chickens in live poultry markets were infected.

BirdLife International, a conservation group, reckons there are three likely transmission routes for H5N1: commercial trade and the movement of poultry; trade in wild birds; and the use of infected poultry manure as agricultural fertiliser. Bird conservationists add that although migratory birds can carry and transmit the virus, it is often not clear whether they picked up the infection from poultry.

In Nigeria, there is the suggestion that it was trade, and not migratory birds, that caused the outbreak. For one thing, the infection was first detected in a commercial farm with 46,000 poultry and not among backyard flocks which represent 60% of the country's poultry production—and which would be expected to have greater contact with wild birds.

The United Nations Food and Agriculture Organisation (FAO) estimates Nigeria imports around 1.2m day-old chicks every year. Further, there are rumours that many of these chicks are still arriving from countries with domestic H5N1 infections, such as China and Turkey. Joseph Domenech, head of the animal health service at the FAO's headquarters in Rome, says the importation of chickens from contaminated countries is forbidden.

The Nigerian government is now taking action to eliminate the virus. Its challenge will be to get the message to ordinary Nigerians about the urgent need to cull birds, prevent poultry movement and disinfect farms. Dick Thompson, of the World Health Organisation, responded to a report that Nigerians had been seen retrieving dead chickens from a pit of culled birds by saying it was a “really scary activity and something not been seen before”.

Neighbouring countries are also moving into action. This week a meeting was held in Senegal to try to establish a regional strategy for containment. Money should be available. Last month $1.9 billion was pledged by countries and international groups for the fight against avian flu—half a billion more than expected, which underscores the extent to which the disease is seen as a global threat. Infection across Africa would increase the likelihood that the virus will mutate to become transmissible between humans. But there is another vital dimension: the loss of farm income and of a vital source of protein could also be devastating for Africa. That ought to be food for thought for Europeans worried about a few dead swans.

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Climate change

A blast from the past

Feb 23rd 2006 | ST LOUIS, MISSOURI
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This year's meeting of the American Association for the Advancement of Science included sessions on climatology, dinosaurs, longevity and alien life

SCOTT WING, a palaeo-climatologist at the Smithsonian Institution in Washington, is passionate about the alligators and palm trees he sees dotting the badlands of Wyoming. That vision will surely please many residents of the state, who are even now enduring the bitter cold of winter. It will also strike them as odd, for their frigid mountains are hardly a hospitable home for such denizens of the tropics.

The 'gators and palms that Dr Wing invokes do not, however, live in today's icy Wyoming—and contemplating them does not bring him joy. In fact, they inhabited the area some 55m years ago, during what is known as the Palaeocene-Eocene Thermal Maximum (PETM).

Dr Wing was one of a panel of experts on emissions of ancient greenhouse gases that gathered at the American Association for the Advancement of Science's annual meeting in St Louis last week to share the latest findings on the PETM and other historical warm periods. The reason he is not happy has to do with the most striking thing to emerge from that session: evidence from palaeo-climatology which suggests that today's computer models of climate change could be flawed in ways that dramatically understate the magnitude of future changes.

During the PETM, the Earth's atmosphere heated up, turning Wyoming—and perhaps even the Arctic—rather balmy. Researchers have known for several years that this warm period led to dramatic migrations of animals toward the poles. This, for example, was what probably permitted the ancestors of horses to come into North America for the first time via a land bridge from Asia. Dr Wing presented fossil evidence from Wyoming proving that several plants, too, had made this migration.

Other panellists also presented fossil data, drawn from various sites around the world, confirming details of other past episodes of warming. The main body of this evidence is changes in the chemical properties of the fossilised remains of ancient organisms. Foraminifera are a ubiquitous group of single-celled sea creatures that leave chalky skeletons behind when they die. Shifts in the relative proportions of the light and heavy isotopes of oxygen in these skeletons reflect the temperature at the time that those skeletons formed.

For example, Karen Bice, a researcher at the Woods Hole Oceanographic Institution, and her team studied samples of foraminifera obtained by drilling off the coast of Suriname. She confirmed the warming of tropical waters during the Cretaceous period some 84m-100m years ago. At that time temperatures rose to 38°C, compared with 26°C to 28°C today. Meanwhile, another isotopic ratio, that between the light and heavy forms of carbon in organic matter derived from marine algae, reflects the amount of carbon dioxide in the atmosphere when the algae were alive. Since carbon dioxide is a greenhouse gas, which traps heat in the lower atmosphere and thus keeps the climate warm, carbon-dioxide levels (as measured by carbon-isotope ratios) should be correlated with the palaeo-temperature (as measured by oxygen-isotope ratios). They are.

The drama came when several researchers, including Dr Bice, tried to draw a link between such palaeo-results and the computer models that have been developed to study the modern climate. The snag is that today's climate models, when fed conditions resembling ancient periods, do not produce nearly enough warming to match the levels implied by the fossil record. Dr Bice says it may be that the climate models are not sensitive enough to carbon dioxide, and so come up with temperatures that are too low. Mark Chandler, of Columbia University, who also presented research to the meeting, shares her worry that this indicates these models may also be producing forecasts of future warming that are much too low.

That does not necessarily mean it is time to panic. The models could be right after all, if the palaeo-temperature estimates turn out to be wrong (though the fact that multiple approaches undertaken by rival palaeo-climatologists at different sites generally agree suggests that they are not far off). Another explanation is that atmospheric concentrations of methane, a much more powerful greenhouse gas than carbon dioxide, were far higher than currently thought (though analysis by Dr Bice suggests that methane levels would need to have been an unrealistic 30 times higher than today's levels to explain the palaeo-temperature record).

On balance, it is probably too early to tell. But that is hardly reassuring. As Dr Wing puts it: “This is probably the

single scariest result of deep-time palaeo-climate work. The models we use to predict the future have been shown to be conservative, and we don't know why."

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Astrobiology

Waving at the neighbours

Feb 23rd 2006
From The Economist print edition

The search for extra-terrestrial life

HUMAN beings are, on an astronomical timescale, recent arrivals—and when you first arrive in the neighbourhood, it is only polite to say hello to the neighbours. That, at least, is the attitude of the SETI Institute. SETI stands for the Search for Extra-Terrestrial Intelligence, and that search has been going on, in various institutional guises, since 1960.

The SETI Institute's members reckon the best way to get in touch is by radio, so they have begged and borrowed time on the world's radio telescopes to listen either for signals deliberately being broadcast by other technological species who want to make themselves known, or for radio signals intended for domestic alien consumption that have simply leaked into space. So far, though, they have heard nothing.

Part of the problem is probably that intelligent aliens are thin on the ground and there are an awful lot of stars. With this in mind, Margaret Turnbull of the Carnegie Institution of Washington, DC, has, as she explained to last week's meeting of the American Association for the Advancement of Science, been trying to refine the target list by going through the catalogue of the 120,000 stars closest to Earth and eliminating unsuitable ones to leave a subset of “habstars” with more potential to support intelligent life.

Dr Turnbull starts from the premise that every star has a zone around it with the right temperature to support carbon-and-water-based life, the only sort so far known to exist. If there are suitable planets in this zone, they might contain life.

First to be tossed out, therefore, are stars lacking the metallic elements needed for planet formation. Astronomers have a rather odd definition of a metal, so that any element heavier than helium counts. Carbon, oxygen, nitrogen and silicon are all metals in the astronomical sense. Dr Turnbull, though, uses iron, a real metal, for her assay. A star's light reveals how much iron it contains, and thus whether planets are likely to have formed around it.

After that, variable stars are thrown out, since they have moving habitable zones. Most binary stars go, too, because planets orbiting them would move in and out of the habzone. And stars that have ballooned into red giants or dwindled into white dwarfs are also rejected.

Finally, she throws out stars that are too young. Some of these are obvious, because they are burning so fast that they will never make their three billionth birthdays, which is the minimum amount of time that Dr Turnbull reckons is needed to go from uninhabited rock to technological civilisation. Other, slower-burning stars have their light analysed to see how much helium they contain, and thus how long they have been fusing hydrogen to helium to power themselves.

The result is a list of 17,000 habstars—still quite a lot, but far fewer than if the search were carried out exhaustively. If ET is out there, his hunters now have a better idea where to look.

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Palaeontology

Doyouthinkhesaurus?

Feb 23rd 2006
From The Economist print edition

There is more to studying dinosaurs than just digging up bones

THE days when fossil-hunters bestrode the globe, smashing ancient beliefs with blows from their geological hammers, are long gone. But fossils still fascinate. And a session at last week's meeting of the American Association for the Advancement of Science devoted entirely to the beasts showed that no group of fossils is more fascinating than the dinosaurs.

The presiding genius of modern dinosaurology, and co-organiser of the session, is Jack Horner, of Montana State University, on whom the character of Alan Grant in “Jurassic Park” is modelled. Dr Horner and his disciples have changed the image of dinosaurs from the lumbering, pea-brained swamp-dwellers of 19th–century dioramas to the alert, co-operative hunters of Michael Crichton's story by clever interpretation of the details of fossil bones. Indeed, the session's co-organiser, Mary Schweitzer of North Carolina State University, has found that there is more than just bone in some fossils. Excitingly, there are also remains of the dinosaurs' flesh and blood.

Dr Horner's trick was to look not just at the fossils, but inside them, by cutting the bones open and studying them under the microscope. This approach has yielded a surprising amount of information about dinosaur life history. For example, bones have growth rings in them, in much the same way that tree trunks do. In modern animals these growth rings are almost always annual, so it is reasonable to assume that those in dinosaur bone are, too. By counting the rings, Dr Horner showed that the herbivorous duckbilled dinosaurs of the Cretaceous became fully grown in seven or eight years. *Tyrannosaurus*, by contrast, took 20 years and *Brontosaurus* a full 30 years.

Another piece of Dr Horner's work confirms the theory that modern birds are descended from dinosaurs, for birds and dinosaurs share bony features called marrow tubes that are not found in other reptiles. He has also been able to show, again by comparison with modern birds, which dinosaurs were up and running as soon as they hatched, and which stayed in the nest waiting for their parents to come and feed them.

Furthermore, the bones of some dinosaur hatchlings, notably the duckbills, were actually made largely of cartilage, like those of nest-bound birds. Such animals could not have walked around as their bones were not strong enough. Meat-eaters of the tyrannosaur persuasion, however, were up and running straight away. Their bones were made not of soft cartilage but of proper, hard bone tissue like those of a hatchling ostrich.

The trouble with this approach, informative though it is, is that it is also destructive, and dinosaur fossils are rare. The fashion these days, therefore, is to use medical body scanners rather than diamond saws to look inside bones.

Larry Witmer, of Ohio University, showed how this technique can be employed to learn about dinosaur posture. He used computerised tomography, a sophisticated form of X-ray scanning, to study the details of dinosaur inner ears. For, although the soft tissue of the inner ear is long gone, the three bony semicircular canals in which that tissue resided are often preserved.

Besides being involved in hearing, the semicircular canals are the location of the sense of balance. To achieve that, one of them, the lateral semicircular canal, is always oriented horizontally when the owner is holding its head in the normal position. So, if you know where that canal is, you can work out what that position is—which Dr Witmer duly did. *Tyrannosaurus* held its head horizontally, but its smaller cousin *Nanotyrannus* apparently preferred to look slightly downwards. Meanwhile *Diplodocus*, a member of the same group of dinosaurs as *Brontosaurus*, held its head in a strongly downward-facing posture.

The star of the session, though, was Dr Schweitzer, a palaeontologist who got into trouble in the 1990s for thinking she had found blood cells in a dinosaur fossil, and then making the mistake of going into print in a popular magazine rather than announcing her finding in a peer-reviewed scientific journal.

She has, however, been forgiven, and she published more extensive data on soft tissues in dinosaur fossils last year in *Science*. At the meeting, she reviewed and updated her findings.

The disbelief that attended her initial publication—that chemically unaltered soft tissue could survive for more than 65m years—has now been dispelled. She has shown that her fossils react with antibodies to haemoglobin, the

oxygen-carrying pigment in red blood cells. They also react with antibodies to collagen, the main structural protein in cartilage, suggesting that it is present, too.

She has, she believes, found both blood cells and bone cells that are more or less intact, as well as other soft-tissue features such as fibrous collagen matrices. Sadly, the cells are unlikely to contain intact dinosaur DNA—the idea that fired Dr Crichton's imagination when he penned “Jurassic Park”. But a decade ago no one would have believed that any biomolecule would be preserved from the Cretaceous. It is amazing what you can find if you look for it.

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About sponsorship

Ageing

How to live for ever

Feb 23rd 2006
From The Economist print edition

The latest from the wacky world of anti-senescence therapy

DEATH is a fact of life—at least it has been so far. Humans grow old. From early adulthood, performance starts to wane. Muscles become progressively weaker, cognition fails. But the point at which age turns to ill health and, ultimately, death is shifting—that is, people are remaining healthier for longer. And that raises the question of how death might be postponed, and whether it might be postponed indefinitely.

Humans are certainly living longer. An American child born in 1970 could expect to live 70.8 years. By 2000, that had increased to 77 years. Moreover, an adult still alive at the age of 75 in 2002 could expect a further 11.5 years of life.

Much of this change has been the result of improved nutrition and better medicine. But to experience a healthy old age also involves maintaining physical and mental function. Age-related non-pathological changes in the brain, muscles, joints, immune system, lungs and heart must be minimised. These changes are called “senescence”.

Research shows that exercise can help to maintain physical function late in life and that exercising one's brain can limit the progression of senescence. Other work—on the effects of caloric restriction, consuming red wine and altering genes in yeast, mice and nematodes—has shown promise in slowing senescence.

The approach advocated by Aubrey de Grey of the University of Cambridge, in England, and presented at last week's meeting of the American Association for the Advancement of Science, is rather more radical. As an engineer, he favours intervening directly to repair the changes in the body that are caused by ageing. This is an approach he dubs “strategies for engineered negligible senescence”. In other words, if ageing humans can be patched up for 30 years, he argues, science will have developed sufficiently to make further repairs more effective, postponing death indefinitely.

Dr de Grey's ideas, which are informed by literature surveys rather than experimental work, have been greeted with scorn by those working at developing such repair kits. Steven Austad, a gerontologist based at the University of Texas, warns that such therapies are many years away and may never arrive at all. There are also the side effects to consider. While mice kept on low-calorie diets live longer than their fatter friends, the skinny mice are less fertile and are sometimes sterile. Humans wishing both to prolong their lives and to procreate might thus wish to wait until their child-bearing years were behind them before embarking on such a diet, although, by then, relatively more age-related damage will have accumulated.

No one knows exactly why a low-calorie diet extends the life of mice, but some researchers think it is linked to the rate at which cells divide. There is a maximum number of times that a human cell can divide (roughly 50) before it dies. This is because the ends of chromosomes, structures called telomeres, shorten each time the cell divides. Eventually, there is not enough left for any further division.

Cell biologists led by Judith Campisi at the Lawrence Berkeley National Laboratory in California doubt that every cell has this dividing limit, and believe that it could be only those cells that have stopped dividing that cause ageing. They are devising an experiment to create a mouse in which senescent cells—those that no longer divide—are prevented from accumulating. They plan to activate a gene in the mouse that will selectively eliminate senescent cells. Such a mouse could demonstrate whether it is possible to avoid growing old.

But successful ageing is being promoted here and now. Older people who engage in a lot of social interactions stay young for their chronological age, argues John Rowe, a professor of medicine and geriatrics at the Mount Sinai School of Medicine in New York. Research has shown that people who receive emotional support not only have higher physical performance than their isolated counterparts, but also that they show lower levels of hormones that are associated with stress.

Other work, led by Teresa Seeman of the University of California, Los Angeles, shows that “allostatic load”—the cumulative physiological toll exacted on the body—predicts life expectancy well. It is measured using variables including blood pressure and levels of stress hormones.

Dr Seeman found that elderly people with high degrees of social engagement had lower allostatic loads. They were also more likely to be well educated and to have a high socio-economic status. It would thus appear that death can be postponed by various means and healthy ageing extended by others. Whether death will remain the ultimate consequence of growing old remains to be seen.

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About sponsorship

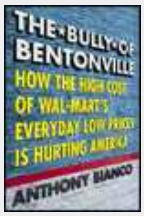
Wal-Mart

The behemoth from Bentonville

Feb 23rd 2006
From The Economist print edition

The world's biggest retailer may have hidden weaknesses

The Bully of Bentonville: How the High Cost of Wal-Mart's Everyday Low Prices is Hurting America
By Anthony Bianco



Doubleday; 336 pages; $24.95

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Wal-Mart: The Face of Twenty-First-Century Capitalism
Edited by Nelson Lichtenstein

New Press; 349 pages; $21.95 and £12.99

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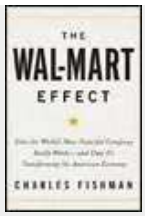
The Wal-Mart Effect: How the World's Most Powerful Company Really Works—and How It's Transforming the American Economy
By Charles Fishman



Penguin Press; 294 pages; $25.95. To be published in Britain by Penguin/Allen Lane in May

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Get article background

WAL-MART is not just the biggest company in America built by someone who, when he died, was the richest man in the country. It is also a focus for much of America's unease with a society in which the consumer is such a powerful king. Wal-Mart panders to no one but its customers, mostly small-town Americans enticed by its promise to provide everyday low prices, always.

Founded by Sam Walton (“Mr Sam”), a folksy shopkeeper from the Ozark mountains who was once described by an old friend as “cold as a Sunday night supper”, the company grew vast on the narrowest of profit margins. All its efforts were focused on cutting costs; it had to fulfil its promise to the consumer.

The stories of its penny-pinching are legendary: top executives on sales trips sharing hotel rooms; vice-presidents furnishing their offices with suppliers' free samples. For a while now, though, the pinching has been nipping too painfully for some. To paraphrase the title of a recent film about the company, the high cost of Wal-Mart's low prices has become too much to bear. The pinched are punching back. In 2004 the ethnically mixed Los Angeles suburb of Inglewood voted (almost unprecedentedly) to keep Wal-Mart out, partly in the widespread belief that it destroys local shopkeepers. One hothead described the company as “a modern-day plantation”.

More recently the state of Maryland passed legislation forcing non-unionised retailers, a close proxy for Wal-Mart, to spend a minimum amount on health-care benefits. The health-care costs of Wal-Mart's lowly paid, non-unionised workers fall heavily on government in a country where such costs are usually picked up by employers.

These three books record in very different ways various aspects of the Wal-Mart phenomenon. Anthony Bianco does not hide his bias. He is in there among the shelves reading the bar codes of the beast of Bentonville, the Arkansas home town of the retailing giant. He describes vividly the company's secretive culture, the inward-looking, deeply religious white Anglo-Saxon Protestant communities of the Ozarks that gave birth to its first three leaders, each so right for his time: Mr Sam, the consummate salesman; then the “shy and charm-challenged” David Glass, who built up the company's huge data warehouse, with a capacity 35 times that of Amazon; on to today's boss, Lee Scott, the king of distribution who measured—to the last mile—just how far Wal-Mart's huge fleet of lorries had to travel.

The biggest internal stain on Wal-Mart's reputation has come, not coincidentally, from an outsider. Tom Coughlin, a burly security guard who rose to be number two in the company, was forced to resign last year. Last month

prosecutors agreed that he should serve more than two years in prison for embezzling over $400,000 from the company. Mr Coughlin was born in Cleveland and educated in California. An Ozarker only by calling, he was never the real thing.

Wal-Mart's “icon is the intermodal container,” writes Nelson Lichtenstein of the University of California in “Wal-Mart: The Face of Twenty-First-Century Capitalism”. The book, a series of piercing academic lights shone upon small corners of the Wal-Mart phenomenon, is surprisingly enhanced by some evocative black and white pictures of early Wal-Mart stores and Ozark farms. Sometimes, however, the contributors seem to stray too far from their academic disciplines. In writing about Asda, Wal-Mart's purchase in Britain, Mr Lichtenstein says that Asda “took over Sainbury's in 2003”. Even spelt correctly that is simply wrong.

In many ways the most satisfying of the three books is “The Wal-Mart Effect”, a study of the phenomenon rather than the retailer. It has frequent unexpected insights—for example, it points out how Wal-Mart has to some extent persuaded its customers to hold its stock for it. When goods, such as underwear, for example, are sold in big boxes placed on pallets, each customer buys many more than if the goods were offered on shelves, thus apparently storing them at home for future use and paying Wal-Mart up-front for the privilege.

Wal-Mart's story still has a long way to run, and each of these books throws up ideas about where it all might lead. There are still large parts of America with untapped potential, in California in particular. Overseas, India and China remain virtually untouched, although retailers have traditionally found it difficult to cross borders, and Wal-Mart itself has had hard times in Germany and Japan. Then there is the online possibility. On Thanksgiving Day last year, there were more visitors to Wal-Mart's website than to Amazon's—the first time that has ever happened. Finally, there is the possibility of a move upmarket. Wal-Mart now sells organic food and Levi's (a brand made specially for the store). In order to please middle America it wants to sell more such things.

The company is no retailing pioneer. Mr Sam more or less stumbled on the formula, and many of its best ideas have been borrowed from others: the selling of goods out of boxes on their pallets came from the French group Carrefour, while the practice of holding meetings in rooms without chairs was first spotted at Asda's headquarters in Leeds, England. Powered, however, by the tough Protestant ethic of its Ozark managers, Wal-Mart adopted them into its price-paring strategy to withering effect.

Its main competitive advantage remains its sheer efficiency. It is a superb operation, a marvellously lean machine that can run on any fuel—organic food, upmarket jeans or whatever. If it has a weakness, however, it may be that very efficiency. It is possible in today's corporate world to be too lean. Wal-Mart's supply chain, for example, is now stretched so taut that one small snafu—avian flu in China, a computer virus in Bentonville or a dockers' strike in Los Angeles—could one day just cause the whole thing to snap. Not even its worst enemies would enjoy the consequences of that.

The Bully of Bentonville: How the High Cost of Wal-Mart's Everyday Low Prices is Hurting America.
By Anthony Bianco.
Doubleday; 336 pages; $24.95

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About sponsorship

New novels

Not science fiction

Feb 23rd 2006
From The Economist print edition

THE recent stem-cell scandal in South Korea may have made front-page news across the world, but few readers are likely to bet that a literary novel set in a laboratory and based on scientific research might end up being a page-turner. Readers of “Intuition”, however, will battle with themselves over whether to savour Allegra Goodman's exquisite filleting of character, as the scientists are themselves dissected like their experimental mice, or to rush headlong to find out what happens next.

In an under-funded Harvard laboratory, the dogged, unglamorous slog towards finding a cure for cancer is under way. Suddenly one research assistant's experiment bears fruit. After mice infected with human breast-cancer cells are injected with Cliff's R-7 virus, their tumours melt away in 60% of the population. But are Cliff's results too good to be true? The question of whether the R-7 results were fiddled powers the remainder of the book.

Intuition
By Allegra Goodman

Dial Press; 344 pages; $25

Buy it at
Amazon.com
Amazon.co.uk

Ms Goodman follows the good novelist's credo that plot proceeds from character; and she follows the good scientist's credo that objective truth is inexorably coloured by whoever stands to lose or gain by it. All the researchers in “Intuition” are sympathetic, and they are all screwed up. Sandy, co-director of the lab, is a charismatic dynamo, but too enamoured with worldly glory. His brilliant, shy partner Marion has impeccable research standards, but is undermined by chronic self-doubt. By contrast, Cliff is glibly over-confident. Robin, R-7's whistle-blower (also Cliff's former girlfriend), is a natural scientist, but her determination to uncover fraud may be driven by romantic disappointment. Robin is heeding her intuition, and “young researchers had their intuition tamped down lest, like the sorcerer's apprentice, they flood the lab with their conceits.”

What a relief to find a novel that does not take place in the literary salons of London or New York. Ms Goodman manages fully to inhabit another profession's world. Her characters so live and breathe on the page that they could get up and make you a cup of coffee while you finish another chapter. Her writing is rich, so rich it would be easy to miss how skilful is the prose itself. Exciting and, for most, exotic as well, “Intuition” is a stunning achievement.

Intuition.
By Allegra Goodman.
Dial Press; 344 pages; $25

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About sponsorship

Israel's wall

Where grown men cry

Feb 23rd 2006
From The Economist print edition

TO THE Israelis it is a security fence or separation barrier; to Palestinians “an apartheid wall”. The two sides agree that it is ugly, both in appearance and in effect. Looping around the Israeli-occupied West Bank, thrusting occasional fingers deep into the occupied lands to take in a far-flung settlement block, the wall divides many Palestinians from their own fields and schools, and traps thousands in a Kafkaesque “seam zone”, with the wall to the east of them and the old “green line” border with Israel to the west. Furthermore, the wall is illegal—deemed so by no less an authority than the International Court of Justice in The Hague. Can anything at all be said in its mitigation?

If so, you will not find it in the essays contained in “Against the Wall”. An introductory chapter sets the tone of moral indignation. Israel's barrier, says Michael Sorkin, the editor, is just one more addition to an odious “repertoire of wallings” that include the 38th parallel in Korea and the Mexican-American border. It makes life miserable and dangerous for the Palestinians, it prejudges where the final border between Israel and a future Palestine should be, and, in its “aggressivity and racism”, it narrows the field of the Palestinians' aspirations, locking them deeper into “a grim psychical space where every hope is blocked”. The wall, declaims Mr Sorkin, “ossifies a social physics that holds that two national bodies cannot share the same space at the same time.”

Much follows in this vein, as the chapter titles suggest. They include “Spacio-cide and Bio-politics: the Israeli Colonial Project from 1947 to the Wall”; “Barriers, Walls and Dialectics: the Shaping of Creeping Apartheid in Israel/Palestine”; “Primitive Separations”; “Border Spaces/Ghettospheres”; and “Hollow Land: the Barrier Archipelago and the Impossible Politics of Separation”. In deference to those other “wallings”, the book contains a chapter on “The Great Wall of Capital” (a wonderfully irrelevant lament on the barriers to global economic migration).

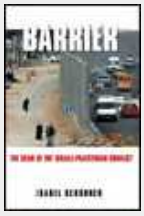
Not all of these essays are quite as one-sided and jargon-tangled as they sound. But if you really wonder why Israel is building its wall, and want to understand its human consequences, you would do far better to invest in Isabel Kershner's readable, compassionate and thoroughly fair “Barrier”. An Israeli journalist, she talks to victims and activists from both sides of the line, bringing lives and landscape vividly to life at the same time as putting the wall in its political context.

Against the Wall: Israel's Barrier to Peace
Edited by Michael Sorkin

New Press; 273 pages; $19.95 and £10.99

Buy it at
Amazon.com
Amazon.co.uk

Barrier: The Seam of the Israeli-Palestinian Conflict
By Isabel Kershner



Palgrave Macmillan; 256 pages; $24.95 and £14.99

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The idea started on Israel's left, and was at first reviled on the right because it would signal plainly in concrete the end of the dream of a Greater Israel in the whole of the West Bank. Ms Kershner also does Israelis the common decency of taking seriously, as one should, the claim that one of the wall's primary purposes, and the reason for its popularity, was a desire to defend themselves from the suicide-bombings of the recent *intifada*—a claim which the judges in The Hague dismissed on a technicality and which is hardly mentioned in the essays of “Against the Wall”.

The dominant tone of that book is Manichean: the wall is a monstrous manifestation of what most of the essayists deem the sinister “ethnocratic” design of Zionism. The dominant tone of Ms Kershner's book is one of poignancy, captured best in the parallel interviews she conducts on each side of the line with Avi Ohion of the left-wing Kibbutz Metzer in Israel and Burhan Sirhan of the wretched Tulkarem refugee camp in the West Bank.

In November 2002 Mr Sirhan's son crossed the green line, kicked in the door of one of the Metzer bungalows and shot dead Mr Ohion's wife and two young sons. Through Ms Kershner, Mr Sirhan, a sad veteran of the Palestinian struggle, sends the father his condolences: “You lost your children and I lost my son through this crazy war.” Mr Ohion, in tears, is unconsoled. In the end, he recognises that there will be a Palestinian state. “In the meantime the fence has to go up all the way, however brutal it may be, in order to save life.” Grown men are crying on both sides of the wall.

Against the Wall: Israel's Barrier to Peace.
Edited by Michael Sorkin.
New Press; 273 pages; $19.95 and £10.99

Barrier: The Seam of the Israeli-Palestinian Conflict.
By Isabel Kershner.
Palgrave Macmillan; 256 pages; $24.95 and £14.99

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Politics and religion

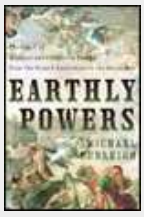
Clash of titans

Feb 23rd 2006
From The Economist print edition

IN FRANCE, a Jewish-born cardinal defends the country's secular system and insists that it must not be watered down to accommodate Muslims. In Italy, a nation that cheerfully ignores Roman Catholic teaching on contraception, many citizens are indignant over the removal of crucifixes from school walls. In the tense atmosphere that gripped Britain after last summer's London bomb attacks, people who had never been near a church were heard to mutter: “I suppose it's going to be a crime to be a Christian soon!”

Europe's religious scene is rich, diversified and contradictory. It presents a far more subtle picture than is suggested by the American caricature of Europeans as feeble and benighted atheists. In some places—Britain and Scandinavia, for example—active commitment to Christianity may be fairly weak but national Christian churches enjoy ancient privileges. France has formally excluded religion from the public arena, but that has not prevented faith from surviving in vigorous pockets. In Spain and Italy, where intellectual and cultural life is steeped in Roman Catholicism, people are at once anti-clerical, blasphemous and intensely protective of their Christian heritage.

Earthly Powers: The Clash of Religion and Politics in Europe from the French Revolution to the Great War
By Michael Burleigh



HarperCollins; 544 pages; $29.95 and £25

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For a deeper understanding of this peculiar state of affairs, there could hardly be a better place to turn than Michael Burleigh's encyclopedic account of religion and politics in Europe between the French revolution and the first world war, in which a vast range of material is handled in a deft, readable way. Mr Burleigh's “The Third Reich” won the Samuel Johnson prize for non-fiction. Drawing in part here on his expertise as a historian of modern Germany and the Nazi movement, Mr Burleigh traces—in one country after another—the process whereby religious understandings of reality and identity were replaced by the ideologies of the modern world: secular or semi-secular notions of national identity, as well as belief in science, progress and technology.

What makes this book excellent is its understanding of the way in which religion fought back, mutated and often remained relatively robust in the places where it came under attack. In particular, the book sheds light on the subtle interplay between traditional religion, secularism and religious nationalism—a dynamic which is crucial to understanding the modern politics of the Balkans, the Middle East and many other places.

The relationship between a universal religion—like Christianity or Islam—and earthly political communities will never be a simple one to describe. On the face of things, these world religions are subversive of all national, administrative or ethnic divisions—because they recognise only one distinction, between believers and unbelievers, as having ultimate importance.

But as Mr Burleigh's book shows, the decline of old-fashioned religion and the rise of secular nationalism—which, of course, resembles religion in its claim to deal in eternal truths—was never a simple, zero-sum affair. Among all the European nations or proto-nations threatened by the power of revolutionary France, “national” resistance to French expansionism was fused with religious indignation over the impiety of the new French order; that gave a new burst of legitimacy to clerical elites which might otherwise have declined faster.

Among religiously divided nations like the Germans, modern nationalism meshed more easily with Protestantism than it did with Catholicism, where loyalty to a newly united “nation” was at odds with the old allegiance to the Vatican's supra-national authority. But that did not prevent a profound convergence of religion and nationalism in two bastions of Catholicism—Poland and Ireland.

Mr Burleigh is good at showing how weak and hollowed-out religion was in places where it seemed strong, such as Victorian England: those vast churches were a reflection not of imperial confidence but of official panic at the plunge in religious observance. Despite the complexity of all these movements and counter-movements, it was a widespread assumption, until quite recently, that the relationship Mr Burleigh is examining could evolve in only one direction. People thought religion as a social category and token of identity would gradually lose ground—either to

modern nationalism or to liberal or Marxist internationalism. But in the Middle East recently, the opposite has been happening: secular Arab nationalism seems to be in decline, and the *umma* or world community of Muslims is regaining importance. In the face of this development, Europeans need a subtle understanding of their own (often unexamined) assumptions about religion and politics. This book, first published in Britain last October and now coming out in America, is an excellent place to start.

Earthly Powers: The Clash of Religion and Politics in Europe from the French Revolution to the Great War.
By Michael Burleigh.
HarperCollins; 544 pages; $29.95 and £25

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The Ottoman empire

Bridge across the Bosporus

Feb 23rd 2006
From The Economist print edition

MORE than 80 years after being supplanted by the Turkish republic, the Ottoman empire will not die. Bloodshed in the Balkans; Arab and Kurdish nationalism across the Middle East; Turcophobia in Armenia; all are echoes of a dynasty that survived for 600 years and whose dominions extended from the Danube through the Levant to Algiers. Few historians have dared compress the story of this extraordinary enterprise into a single volume. “Osman's Dream” shows why.

Osman led one of several Turcoman tribes, of Central Asian descent, that were competing for control of Anatolia at the beginning of the 14th century. (The dream in question was interpreted to mean that Osman would found an imperial house; “Ottoman” is the European corruption of his name). By the mid-16th century, Osman's descendants had killed off the Byzantine Empire and turned its capital, Constantinople (renamed Istanbul), into the world's greatest mosque city. They also had control of the Muslim holy places, Mecca and Medina, in Arabia.

The empire's expansion was driven in part by Islamic notions of a just war against the infidel, but the Ottomans were also notable for their relative tolerance. Jews fleeing the Spanish inquisition were welcomed to Istanbul. Christian converts became key figures in the bureaucracy, armed forces and the harem. Even at the empire's peak, however, the tide of history was turning in Europe's favour. Challenged by the Europeans' intellectual and military prowess, hampered by the fiscal ineptitude of its leaders, and powerless to suppress the petty nationalisms that infected its Balkan possessions, the empire began to unravel—at times abruptly, at others imperceptibly.

With her doctorate in the fiendishly complex discipline of Ottoman studies, Ms Finkel is ideally placed to make sense of this. But “Osman's Dream” leaves one with the impression that the author's scholarship—she includes a 30-page bibliography—could have been put to better use. Her apparent desire to record every event of significance sometimes results in a dispiriting succession of military campaigns and diplomatic intrigues; one would have preferred a pruning of the thicket of events and more discussion of what it all means.

The author offers glimpses of a more satisfying book. She includes a suggestive aside on the blending of French and Persian inspirations in the Ottoman palace-building of the early 18th century—as good an emblem for the empire's strained multiculturalism as you could wish for. There are tantalising allusions to both the fascination and the repulsion which animated the later Ottomans' ambivalence towards Europe. And one wishes that Ms Finkel had developed her intriguing defence of the empire in the 19th century, “multi-confessional, geographically incoherent and economically backward”, in the face of demands, on the part of impertinent Europeans, that it reform internally.

The limitations of Ms Finkel's approach are most apparent in her perfunctory treatment of the empire's final, tumultuous years. She deals no more than cursorily with the Armenian massacres during the first world war, preferring to observe that scholarship has suffered from the highly-charged contemporary dispute over whether the killings constitute genocide. This point would have made a worthwhile footnote. As a substitute for an account of what happened, it is a cop-out.

Osman's Dream: The History of the Ottoman Empire.
By Caroline Finkel.
Basic Books; 660 pages; $35. John Murray; £30

Osman's Dream: The History of the Ottoman Empire
By Caroline Finkel

Basic Books; 660 pages; $35. John Murray; £30

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New theatre

Fiennes finessing

Feb 23rd 2006
From The Economist print edition

“Faith Healer” deserves a second chance

AP

A laying on of hands

WHEN “Faith Healer”, Brian Friel's quietly taut recitative had its world premiere on Broadway in 1979, in a production starring the late James Mason, it closed within three weeks. So why then is a new production, which is previewing in Dublin before moving to Broadway, virtually sold out? The answer, in a nutshell, is Ralph Fiennes.

“Faith Healer”, about a man who may or may not be a quack, is antithetical to the sort of high-octane Big Moment theatre on which Broadway thrives. But in the quarter-century since its abortive debut, the play has quietly asserted itself as one of Mr Friel's finest works, an intricate theatrical puzzle that is at once a droll if ultimately shocking story and a wounding meditation on the nature of art.

Mr Fiennes is first glimpsed in dimly lit profile, a shadowy presence with an even more elusive tale to tell. Frank Hardy is an Irishman who has made his way through the backwaters of Scotland and Wales curing the diseased and infirm. Under any normal circumstances he would be quickly dismissed as a con were there not rare occasions when his talent for healing had actually worked.

Mr Friel first gives Frank's version of events, then that of his wife, Grace, and—in a knockout performance from Ian McDiarmid, reprising a role he has previously played in London—that of his Cockney manager, Teddy. The end returns to Frank for a final segment in which the dispenser of balm is himself healed, albeit at a terrible cost.

At the start, Mr Fiennes seems both too young for the role and too cool, but such doubts soon give way when confronted with the actor's elegant voice, which is as seductive as it is sepulchral. Will “Faith Healer” be second time lucky on Broadway? Time will tell, just as it has long since affirmed the greatness of a play that proves more mournfully, compassionately prismatic with each new viewing. Don't bet on failure.

“Faith Healer” is at the Gate Theatre, Dublin, until April 1st and then at the Booth Theatre, New York, from May 4th to July 30th.

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About sponsorship

Robert Rich

Feb 23rd 2006
From The Economist print edition

Robert Rich, inventor of frozen non-dairy topping, died on February 15th, aged 92

Rich's

AS SALES presentations go, the one Robert Rich gave in Long Island, New York, in the summer of 1945 was one of the more nerve-wracking. Eighteen sales reps faced him. Mr Rich had brought along some samples of his new invention, a concoction of soy-oil shortening, isolated soya protein, corn syrup and water, in the hopes of persuading them that this could taste as yummy, and whip as lightly, as heavy cream. To keep them from the heat, on the long train journey from his home in Buffalo, he had wrapped the samples stoutly in dry ice and newspaper. Now they hit the table with a thud, frozen solid.

Mr Rich kept talking. As the words flowed, he took a knife surreptitiously to the chunks of “cream”, trying to soften them. When words ran out, he turned the hand-beater on them; and they whipped like a dream. White, unctuous, splendid stuff rose up in mounds, as in the picture above, where Mr Rich holds the bowl.

Few revolutions have been made with a hand-beater. But Mr Rich's was one. Before he began to experiment with flaking and precipitating soyabeans, whipped cream was a hit-or-miss affair. It would not keep, especially in the humid South. Nor would it freeze. Over-beating produced a buttery mess, and ambitious decorations sank gradually into gloop. To top it all, in wartime, heavy whipping cream was a banned substance. All available milk was needed fresh for the people, or dried and condensed for the troops. To dream of an éclair or a cream puff, even of a modest dollop nestling a cherry or topping off a sundae, was close to a traitorous act.

Mr Rich, however, dreamed often of whipped cream. His boyhood had been spent in and out of his father's ice-cream plant, and in 1935 he started such a plant himself, the Wilber Farms Dairy in Buffalo. He should have been fat, but he was a fine and fit sportsman, captain of both football and wrestling at university. Possibly he might have gone into sports professionally. But Mr Rich became fascinated with the process by which, through a series of vats and pipes and settling beds, the humble and ubiquitous soyabean could be made to do the work of a cow.

Henry Ford, as it happened, was then attempting the same thing. When Mr Rich went to Michigan as the government's local administrator of milk orders, in 1943, he inspected Ford's soya-milk-making machinery and was offered a licence to the process for a dollar a year. That offer was later withdrawn (Ford officials telling him, with attractive candour, that they sold a lot of tractors to dairy farmers). Mr Rich therefore devised his own in the garage of his dairy, adjusting it to turn out cream. As his chemists laboured to find the best emulsifiers and flavourings, the world's first non-dairy topping, Delsoy, was creeping from rival nozzles elsewhere in the state. But since Delsoy could not be frozen, it never got beyond Detroit.

Mr Rich's topping did. Before his trip to Long Island he had promoted it rather diffidently to customers on his milk round. Afterwards, knowing that his invention both froze and could be whipped from frozen to three or four times its volume in minutes, he began to sell it everywhere. His topping could be kept, without spoiling, for six months; it kept a hard, neat edge in decoration; it was twice as nourishing as cream, but cheaper and non-fattening. The taste, especially once he had added corn syrup and coconut oil, was plausibly that of cream. His name did it no

harm either. “Whip Topping” was bland; but “Rich's Whip Topping” hinted effortlessly at an experience that was thick, indulgent, faintly golden and utterly unwarlike.

A quart of trouble

Utterly uncreamlike, too, cried the dairy trade, and raced to court to stop him. On 42 separate occasions from 1949 onwards, Mr Rich had to defend his topping and, later, his non-dairy Coffee Rich whitener from furious milk men. He was not imitating cream, he argued, but replacing it with something better, as the car had replaced the horse. Mr Rich became a leading light in the new National Association for Advanced Foods, with other soyabean experimenters, and let the red-faced representatives of unadvanced foods impound his coffee whitener if they felt like it. He won every case.

Meanwhile, he had also diversified into éclairs, cake frosting and (less successfully) Chil-Zert, a soya-based ice cream. He began to bake dough for pizza companies and supermarkets, and to make desserts for schools. His topping spread across America. Today's Rich Products Corporation website shows desserts almost unimaginable before his revolution: a world of pies topped with white peaks, swirls, whirls and swags, of multicoloured doughnuts and flawless, thick-frosted cakes. One sequence shows a strawberry milkshake with a perfect red rose, but still missing something. Smoothly, Rich's Whip Topping morphs on.

Eventually, Mr Rich's business became, as it remains, the biggest family owned food-service company in America, with 2,300 products, sales of $2.5 billion last year and plants all over the world. In 1990 Mr Rich was among the first four people inducted into the Frozen Food Hall of Fame. He joined Clarence Birdseye and his fish fingers; but, unlike Birdseye, he had not really meant to freeze his “cream” at all.

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Overview

Feb 23rd 2006
From The Economist print edition

After a slow third quarter, **Japan's economy** surged in the final three months of 2005. The yen value of GDP grew at an annual rate of 3.5%; real GDP grew by 5.5%. The expansion was led by domestic demand, which contributed two-thirds of the nominal growth. Prices, according to the GDP deflator, fell by 1.6% from the previous year, following a fall of 1.3% in the year to the third quarter.

Oil prices rose again after Nigerian militants attacked oil facilities in the Niger Delta and abducted foreign oil workers. The disruption cut Nigerian oil production, normally 2.4m barrels per day, by almost one-fifth. The price of West Texas Intermediate crude breached $60 a barrel this week and rose to almost $63, before falling back.

Higher energy prices were responsible for a jump in American **inflation**. Consumer prices rose by 0.7% in January, leaving them 4% higher than a year earlier. Core prices, excluding food and energy, rose by only 0.2% in the month, and by 2.1% over the year.

Some policymakers at the **Federal Reserve** are worried that higher energy prices and the diminishing slack in the economy could raise inflationary pressure, according to the minutes of the Fed's rate-setting meeting on January 31st. Others noted that the slowdown in the housing market might raise the household saving rate, undermining demand. Interest rates are close to where they need to be, the minutes said, but “some further policy firming might be needed”.

Similar worries about pricey oil and faltering house prices may be haunting America's consumers. The University of Michigan's index of **consumer sentiment** fell unexpectedly. But housebuilders seem undeterred. Construction of **new homes** rebounded, up by 14.5% from December and 4% from January 2005.

The **euro-area** economy is maintaining its momentum, according to EuroCOIN, a monthly indicator of current activity. Its reading of 0.58 in January, barely changed since October, suggests growth is slightly above its trend rate. Industrial production in the 12-member block edged up by 0.1% in December to give a 12-month gain of 2.5%.

New details on **Germany's** fourth-quarter GDP showed that what little growth it enjoyed came from a build-up of inventories. Private consumption, government spending and overseas trade all detracted from Germany's end-of-year performance.

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Output, demand and jobs

Feb 23rd 2006
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2005	2006	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.6	Q3	+ 0.6	+ 2.5	+ 3.1	+ 1.3	Q3	+ 1.9	Q4	5.3	Jan	5.1
Austria	+ 2.1	Q4	+ 2.8	+ 1.9	+ 2.1	+ 2.8	Nov	+ 1.5	Nov	5.1	Jan	5.0
Belgium	+ 1.5	Q4	+ 2.4	+ 1.4	+ 2.0	+ 2.2	Dec	nil	Nov	12.9	Dec†	12.8
Britain	+ 1.7	Q4	+ 2.4	+ 1.7	+ 2.1	– 2.7	Dec	+ 1.3	Jan	5.1	Dec††	4.7
Canada	+ 2.8	Q3	+ 3.6	+ 2.9	+ 3.2	+ 1.5	Nov	+ 3.9	Nov	6.6	Jan	7.0
Denmark	+ 4.8	Q3	+ 5.7	+ 3.3	+ 2.8	+ 5.5	Dec	+ 4.8	Dec	5.1	Dec	6.1
France	+ 1.2	Q4	+ 0.9	+ 1.6	+ 2.0	– 0.4	Dec	+ 2.1	Dec	9.5	Dec	10.0
Germany	+ 1.0	Q4	nil	+ 1.1	+ 1.7	+ 3.4	Dec	– 0.9	Dec	11.3	Jan§	11.5
Italy	+ 0.1	Q3	+ 1.1	+ 0.1	+ 1.2	+ 3.5	Dec	+ 0.4	Nov	7.5	Sep	7.9
Japan	+ 4.2	Q4	+ 5.5	+ 2.6	+ 2.5	+ 3.8	Dec	+ 1.2	Dec	4.4	Dec	4.5
Netherlands	+ 1.6	Q4	+ 3.9	+ 0.9	+ 1.9	+ 1.4	Dec	+ 4.0	Nov	6.2	Jan**	6.6
Spain	+ 3.5	Q4	+ 3.3	+ 3.4	+ 3.0	+ 0.9	Dec	nil	Dec	8.5	Dec	10.3
Sweden	+ 3.4	Q3	+ 3.9	+ 2.6	+ 3.2	+ 2.7	Dec	+10.7	Dec	6.3	Jan†	5.5
Switzerland	+ 2.3	Q3	+ 4.3	+ 1.8	+ 2.2	+ 2.8	Q3	+ 3.1	Dec	3.9	Jan†	4.1
United States	+ 3.1	Q4	+ 1.1	+ 3.6	+ 3.3	+ 3.1	Jan	+ 4.4	Dec	4.7	Jan	5.2
Euro area	+ 1.7	Q4	+ 1.2	+ 1.4	+ 1.9	+ 2.5	Dec	+ 0.8	Dec	8.4	Dec	8.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.5	Q4	+ 3.7	na	na	– 1.4	Dec	+ 6.5	Dec	8.2	Jan	8.9
Greece	+ 3.7	Q4	na	na	na	– 0.9	Dec	+ 1.6	Nov	9.7	Q3	10.1
Iceland	+ 4.0	Q3	na	na	na	na		na		1.5	Dec†	2.7
Ireland	+ 4.8	Q3	+ 1.3	na	na	+ 4.3	Dec	+ 5.0	Dec	4.3	Jan	4.2
Luxembourg	+ 3.1	Q1	na	na	na	+ 5.9	Nov	+ 0.2	Dec	5.0	Dec	4.5
New Zealand	+ 2.0	Q3	+ 0.2	na	na	– 2.7	Q3	+ 3.0	Q4	3.6	Q4	3.6
Norway	+ 3.1	Q3	+ 3.2	na	na	+ 2.6	Dec	+ 3.3	Dec	4.5	Dec**	4.4
Portugal	+ 0.2	Q3	– 3.7	na	na	+ 5.1	Dec	+ 1.5	Dec	8.0	Q4†	7.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ††Oct-Dec; claimant count rate 2.9% in Jan. §EU harmonised rate 9.5% in Dec. **Nov-Jan. **Oct-Dec.

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Prices and wages

Feb 23rd 2006
From The Economist print edition

% change on year ago

	Consumer prices latest		Consumer prices year ago	The Economist poll consumer prices forecast 2005	2006	Producer prices latest		Producer prices year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 2.8	Q4	+ 2.6	+ 2.7	+ 2.9	+ 4.8	Q4	+ 8.2	+ 6.1	Q3	+ 3.5
Austria	+ 1.6	Dec	+ 2.9	+ 2.3	+ 1.9	+ 1.7	Jan	+ 4.7	+ 2.7	Jan	+ 2.1
Belgium	+ 2.6	Jan	+ 2.3	+ 2.7	+ 2.2	+ 2.4	Dec	+ 5.3	+ 2.3	Oct	+ 2.4
Britain	+ 1.9	Jan*	+ 1.6	+ 2.1	+ 2.0	+ 2.9	Jan	+ 2.6	+ 3.6	Dec†	+ 4.3
Canada	+ 2.8	Jan	+ 2.0	+ 2.3	+ 2.2	+ 2.5	Dec	+ 3.6	+ 1.5	Nov	+ 2.6
Denmark	+ 2.1	Jan	+ 1.0	+ 1.8	+ 1.9	+ 4.6	Jan	+ 3.0	+ 2.9	Q4	+ 2.9
France	+ 2.0	Jan	+ 1.6	+ 1.8	+ 1.7	+ 3.1	Dec	+ 3.0	+ 3.2	Q3	+ 2.9
Germany	+ 2.1	Jan	+ 1.6	+ 2.0	+ 1.7	+ 2.9	Jan	+ 3.4	+ 0.8	Dec	+ 1.4
Italy	+ 2.2	Jan	+ 1.9	+ 2.1	+ 2.1	+ 4.1	Dec	+ 4.2	+ 2.3	Dec	+ 3.3
Japan	– 0.1	Dec	+ 0.2	– 0.2	+ 0.3	+ 2.7	Jan	+ 1.4	+ 1.6	Dec	+ 0.8
Netherlands	+ 1.3	Jan	+ 1.5	+ 1.5	+ 1.6	+ 5.6	Dec	+ 5.1	+ 1.4	Jan	+ 0.7
Spain	+ 4.2	Jan	+ 3.1	+ 3.4	+ 3.2	+ 5.2	Dec	+ 5.0	+ 1.9	Q3	+ 2.2
Sweden	+ 0.6	Jan	nil	+ 0.6	+ 1.5	+ 6.4	Dec	+ 2.0	+ 3.3	Nov	+ 2.4
Switzerland	+ 1.3	Jan	+ 1.1	+ 1.2	+ 1.1	+ 1.7	Jan	+ 1.3	+ 0.9	2004	+ 1.4
United States	+ 4.0	Jan	+ 3.0	+ 3.4	+ 2.9	+ 5.7	Jan	+ 3.9	+ 3.3	Jan	+ 2.6
Euro area	+ 2.4	Jan	+ 1.9	+ 2.2	+ 2.0	+ 4.6	Dec	+ 3.5	+ 2.2	Q3	+ 1.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.8	Jan	+ 0.2	na	na	+ 5.5	Jan	+ 1.2	+ 3.5	Q4	+ 4.3
Greece	+ 3.2	Jan	+ 4.0	na	na	+ 8.3	Dec	+ 2.9	na		na
Iceland	+ 4.1	Feb	+ 4.5	na	na	+ 3.8	Jan	+ 8.6	+ 8.3	Jan	+ 6.6
Ireland	+ 3.0	Jan	+ 2.3	na	na	+ 3.5	Dec	– 1.6	+ 3.5	Q3	+ 4.7
Luxembourg	+ 2.9	Jan	+ 2.0	na	na	+ 3.5	Dec	+17.0	+ 0.8	Nov	+ 3.9
New Zealand	+ 3.2	Q4	+ 2.7	na	na	+ 6.5	Q4	+ 3.4	+ 3.1	Q4	+ 2.5
Norway	+ 1.8	Jan	+ 1.1	na	na	+25.4	Jan	+11.7	+ 2.6	Q3	+ 4.3
Portugal	+ 2.6	Jan	+ 2.0	na	na	+ 5.3	Jan	+ 4.2	– 0.4	Dec	– 1.8

*RPI inflation rate 2.4% in Jan. †Oct-Dec.

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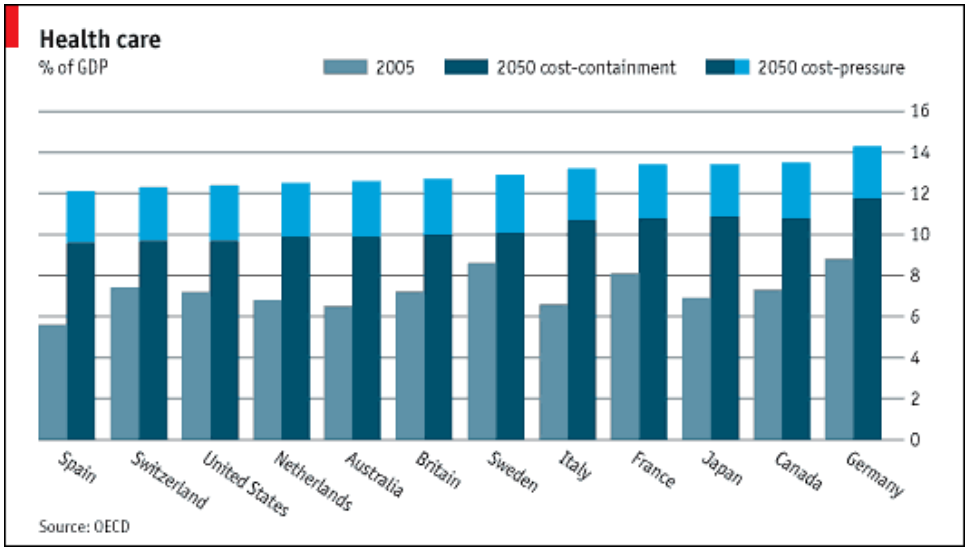
Health care

Feb 23rd 2006
From The Economist print edition



Public spending on health and long-term care currently averages close to 7% of GDP in rich countries. This could nearly double by 2050, according to new projections by the OECD, under a scenario in which cost pressures persist. Even if steps are taken to contain costs, average spending is likely to reach 10% of GDP. The increases are driven by expensive innovations, more costly medical services and population ageing.

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Money and interest rates

Feb 23rd 2006
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Feb 22nd 2006)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 8.1	+ 9.1	Dec	5.60	5.72	5.19	5.22	5.47	6.23
Britain	+ 6.5	+11.7	Jan	4.52	4.84	4.24	4.09	4.74	5.13
Canada	+11.1	+ 7.7	Dec	3.72	2.43	3.91	4.12	4.29	5.38
Denmark	+19.9	+14.7	Dec	2.71	2.20	3.11	3.41	3.71	4.99
Japan	+ 5.3	+ 1.9	Jan	0.03	0.02	0.38	1.52	1.41	1.75
Sweden	+ 2.3	+ 9.9	Dec	1.90	1.95	2.40	3.31	3.80	3.24
Switzerland	+ 1.5	+ 3.3	Jan	1.10	0.75	1.56	2.16	2.15	2.22
United States	+ 1.1	+ 8.1	Jan	4.55	2.81	4.68	4.57	4.27	5.45
Euro area†	+11.3	+ 7.3	Dec	2.62	2.14	2.90	3.39	3.65	3.96

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.48%, Japan No. 276 1.52%. Central bank rates: US fed funds 4.50%, ECB refinancing 2.25%, BOJ overnight call 0.001%, BOE repo 4.5%. Sources: Bank of Canada, Commerzbank, Danske Bank, Global Insight, J.P. Morgan Chase, Stockholmsbörsen, UBS, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Feb 23rd 2006
From The Economist print edition

2000=100

	Feb 14th	Feb 21st*	% change on one month	% change on one year
Dollar index				
All items	155.5	155.4	+ 2.0	+17.5
Food	136.1	138.0	+ 3.0	+11.6
Industrials				
All	180.7	177.9	+ 1.0	+24.2
Nfa†	147.1	149.0	+ 1.1	+16.3
Metals	199.0	193.7	+ 1.0	+27.8
Sterling index				
All items	136.4	135.2	+ 4.4	+28.5
Euro index				
All items	121.1	120.8	+ 5.2	+30.6
Yen index				
All items	169.5	171.5	+ 5.8	+34.2
Gold				
$ per oz	543.85	554.75	- 0.4	+27.7
West Texas Intermediate				
$ per barrel	59.45	60.83	- 9.2	+20.1

* Provisional. † Non-food agriculturals.

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Stockmarkets

Feb 23rd 2006
From The Economist print edition

Market indices

		2005-06		% change on one week	% change on record high	Dec 31st 2004 in local currency	Dec 31st 2004 in $ terms
	Feb 22nd	high	low				
Australia (All Ordinaries)	4,842.5	4,903.9	3,905.5	+ 1.3	- 1.3	+19.5	+12.0
Austria (ATX)	4,134.6	4,158.6	2,415.0	+ 3.9	- 0.6	+70.0	+48.6
Belgium (Bel 20)	3,900.1	3,900.1	2,958.8	+ 3.4	nil	+33.0	+16.2
Britain (FTSE 100)	5,872.4	5,872.4	4,783.6	+ 1.4	-15.3	+22.0	+10.5
Canada (Toronto Composite)	11,800.2	12,080.5	9,006.2	+ 2.1	- 2.3	+27.6	+33.1
Denmark (OMXCB)	379.6	379.6	257.8	+ 1.8	nil	+47.3	+28.3
France (SBF 250)	3,539.9	3,539.9	2,633.6	+ 1.9	-19.4	+34.4	+17.4
(CAC 40)	5,041.6	5,041.6	3,816.1	+ 2.2	-27.2	+31.9	+15.3
Germany (DAX)*	5,862.1	5,862.1	4,178.1	+ 1.7	-27.3	+37.7	+20.4
Italy (S&P/MIB)	38,076.0	38,076.0	30,645.0	+ 3.1	-24.0	+23.2	+ 7.7
Japan (Nikkei 225)	15,781.8	16,747.8	10,825.4	- 0.9	-59.4	+37.4	+18.7
(Topix)	1,609.5	1,713.5	1,109.2	- 0.9	-44.2	+40.0	+21.0
Netherlands (AEX)	466.0	466.0	347.0	+ 1.2	-33.6	+33.9	+17.0
Spain (Madrid SE)	1,272.1	1,272.1	950.9	+ 3.2	nil	+32.6	+15.9
Sweden (Affarsvarlden Gen)	309.8	309.8	218.9	+ 2.4	-22.6	+40.0	+17.9
Switzerland (Swiss Market)	8,040.5	8,040.5	5,669.6	+ 3.1	- 4.4	+41.2	+22.1
United States (DJIA)	11,137.2	11,137.2	10,012.4	+ 0.7	- 5.0	+ 3.3	+ 3.3
(S&P 500)	1,292.7	1,294.2	1,137.5	+ 1.0	-15.4	+ 6.7	+ 6.7
(NASDAQ Comp)	2,283.2	2,331.4	1,904.2	+ 0.3	-54.8	+ 5.0	+ 5.0
Europe (FTSEurofirst 300)†	1,358.1	1,358.1	1,038.6	+ 2.0	-20.3	+30.4	+13.9
Euro area (FTSE Euro 100)†	1,166.9	1,166.9	894.4	+ 2.4	-24.7	+29.5	+13.2
World (MSCI)‡	1,308.6	1,314.6	1,115.0	+ 1.0	- 9.7	+11.9	+11.9
World bond market (Citigroup)††	621.0	662.3	608.7	nil	- 6.2	- 6.8	- 6.8

*Total return index. †In euro terms. ‡Morgan Stanley Capital International Index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Feb 23rd 2006
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2005	2006	Exchange rate trade-weighted† 2000=100 Feb 22nd	year ago	Currency units per $ Feb 22nd	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2005‡
Australia	− 13.6	Dec	− 43.5	Q3	− 5.9	− 5.3	117.5	116.2	1.36	1.27	2.37	1.62	1.15	+ 1.0
Austria	− 2.1	Nov	+ 0.5	Dec	nil	+ 0.1	104.7§	106.2	0.84	0.76	1.46	–	0.71	− 2.0
Belgium	+ 10.9	Dec	+ 8.2	Sep	+ 1.8	+ 2.0	106.2§	108.3	0.84	0.76	1.46	–	0.71	nil
Britain	−119.1	Dec	− 40.6	Q3	− 2.0	− 2.3	98.2	100.2	0.57	0.52	–	0.68	0.48	− 3.1
Canada	+ 55.6	Dec	+ 19.6	Q3	+ 1.9	+ 1.8	126.7	114.7	1.15	1.24	2.00	1.36	0.97	+ 1.3
Denmark	+ 9.6	Dec	+ 8.7	Dec	+ 3.2	+ 3.0	105.9	106.8	6.28	5.64	10.9	7.46	5.30	+ 2.8
France	− 32.0	Dec	− 41.6	Dec	− 1.3	− 1.2	106.9§	109.2	0.84	0.76	1.46	–	0.71	− 3.2
Germany	+200.0	Dec	+112.8	Dec	+ 4.0	+ 3.8	108.3§	110.9	0.84	0.76	1.46	–	0.71	− 3.9
Italy	− 13.1	Dec	− 24.6	Dec	− 1.5	− 1.4	106.5§	108.8	0.84	0.76	1.46	–	0.71	− 4.3
Japan	+ 94.0	Dec	+164.0	Dec	+ 3.5	+ 3.6	81.4	88.1	119	105	206	141	–	− 6.5
Netherlands	+ 40.1	Dec	+ 39.8	Q4	+ 5.0	+ 5.0	107.0§	109.1	0.84	0.76	1.46	–	0.71	− 1.6
Spain	− 96.4	Nov	− 84.0	Nov	− 6.7	− 6.9	104.9§	106.4	0.84	0.76	1.46	–	0.71	+ 0.3
Sweden	+ 19.0	Dec	+ 24.2	Q3	+ 7.0	+ 6.8	95.6	100.2	7.89	6.89	13.7	9.38	6.66	+ 1.2
Switzerland	+ 6.6	Jan	+ 49.3	Q3	+13.5	+13.4	105.8	108.5	1.31	1.17	2.29	1.56	1.11	− 1.6
United States	−782.1	Dec	−780.6	Q3	− 6.5	− 6.6	87.3	81.9	–	–	1.74	1.19	0.84	− 3.7
Euro area	+ 29.1	Dec	− 35.4	Dec	− 0.1	− 0.1	115.8	119.2	0.84	0.76	1.46	–	0.71	− 2.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 10.6	Dec	+ 5.6	Dec	na	na	107.8§	109.8	0.84	0.76	1.46	–	0.71	+ 2.1
Greece	− 34.1	Nov	− 17.5	Dec	na	na	104.0§	105.3	0.84	0.76	1.46	–	0.71	− 4.5
Iceland	− 1.5	Dec	− 2.2	Q3	na	na	109.0**	92.7	67.4	61.0	117	80.1	56.8	+ 2.0
Ireland	+ 40.2	Dec	− 3.7	Q3	na	na	111.4§	115.4	0.84	0.76	1.46	–	0.71	− 0.9
Luxembourg	− 4.8	Nov	+ 3.5	Q3	na	na	106.2§	108.3	0.84	0.76	1.46	–	0.71	− 2.3
New Zealand	− 4.5	Dec	− 9.1	Q3	na	na	133.1	135.7	1.52	1.38	2.64	1.81	1.28	+ 5.3
Norway	+ 49.6	Jan	+ 43.7	Q3	na	na	108.3	106.8	6.79	6.24	11.8	8.07	5.73	+ 15.3
Portugal	− 23.3	Nov	− 16.7	Nov	na	na	104.7**	105.1	0.84	0.76	1.46	–	0.71	− 6.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, December average (corrected data). ‡OECD estimate.
**IMF, October average (corrected data).

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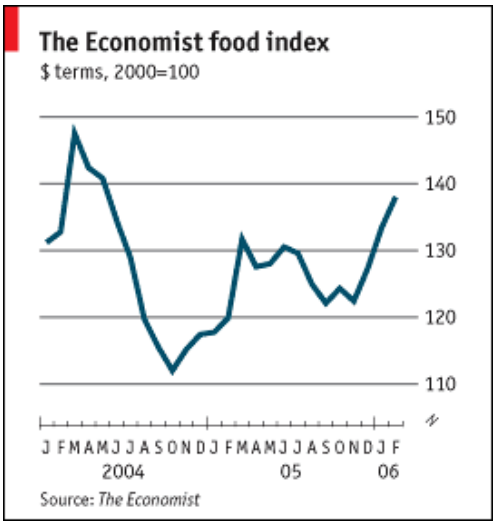
The Economist food index

Feb 23rd 2006
From The Economist print edition

Our food index has risen by 14% since November. Sugar prices hit 25-year highs as world stocks have fallen and more cane has been diverted into ethanol production. Tea prices rose after a drought in Kenya slashed harvests.



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Overview

Feb 23rd 2006
From The Economist print edition

China's 12-month rate of consumer-price inflation rose to 1.9% in January, its highest level for ten months. **Hong Kong's** inflation rate rose to 2.6% in January, a seven-year high. However, its GDP growth slowed to 7.6% in the year to the fourth quarter.

Malaysia's GDP grew by 5.2% in the year to the fourth quarter. Its central bank lifted its overnight policy rate to 3.25%. That left rates around zero in real terms.

In January **Brazil** recorded its first current-account deficit in 14 months. The surplus in the 12 months to January fell to 1.6% of GDP.

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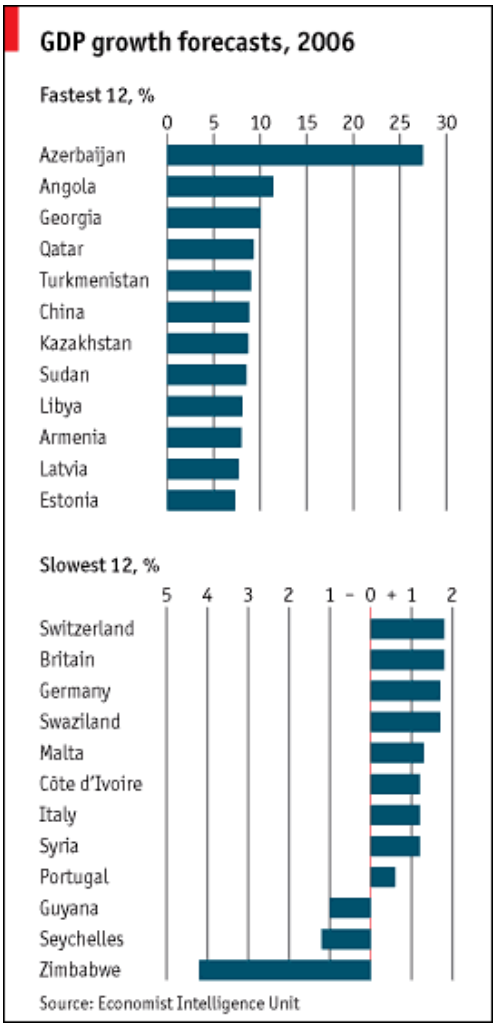
GDP growth forecasts, 2006

Feb 23rd 2006
From The Economist print edition

Zimbabwe will be the world's worst economic performer in 2006, according to the latest forecasts from the Economist Intelligence Unit (EIU), a sister organisation of *The Economist*. Its economy will shrink by more than 4%, the EIU predicts. The fastest growth will belong to those countries that either produce energy or transport it. The EIU reckons that surging exports of oil and gas will help raise Azerbaijan's GDP by 27.5% in 2006, likely to be the fastest rate of growth in the world. Meanwhile, the revenue from oil pipelines will raise Georgia's growth to 10%.



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Economy

Feb 23rd 2006
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.9	Q4	+16.5	Dec	+ 1.9	Jan	+105.1	Jan	+128.5	H1	818.9	Dec
Hong Kong	+ 7.6	Q4	+ 4.1	Q3	+ 2.6	Jan	−10.5	Dec	+21.0	Q3	127.8	Jan
India	+ 8.0	Q3	+ 5.0	Dec	+ 5.6	Dec	−37.4	Jan	−18.3	Q3	133.4	Jan
Indonesia	+ 4.9	Q4	+11.3	Nov	+17.0	Jan	+27.8	Dec	+ 0.7	Q3	33.1	Dec
Malaysia	+ 5.2	Q4	+ 4.2	Dec	+ 3.2	Jan	+26.4	Dec	+18.7	Q3	69.9	Dec
Pakistan	+ 8.4	2005†	+19.3	Sep	+ 8.8	Jan	− 9.3	Dec	− 3.7	Q3	10.0	Dec
Philippines	+ 6.1	Q4	+ 4.0	Nov	+ 6.7	Jan	− 2.6	Nov	+ 2.9	Sep	17.8	Jan
Singapore	+ 8.7	Q4	+ 5.1	Dec	+ 1.8	Jan	+29.6	Dec	+33.7	Q3	120.2	Jan
South Korea	+ 5.2	Q4	+11.3	Dec	+ 2.8	Jan	+20.9	Jan	+16.6	Dec	216.9	Jan
Taiwan	+ 4.4	Q3	+ 4.4	Jan	+ 2.7	Jan	+ 9.6	Jan	+16.4	Q4	257.3	Jan
Thailand	+ 5.3	Q3	+ 6.1	Dec	+ 5.9	Jan	− 7.9	Jan	− 3.7	Dec	50.7	Dec
Argentina	+ 9.2	Q3	+ 7.9	Dec	+12.1	Jan	+11.3	Dec	+ 4.4	Q3	27.2	Dec
Brazil	+ 1.0	Q3	+ 3.2	Dec	+ 5.7	Jan	+45.4	Jan	+13.0	Jan	53.2	Dec
Chile	+ 5.2	Q3	+ 6.0	Dec	+ 4.1	Jan	+ 9.2	Jan	− 0.2	Q3	15.9	Jan
Colombia	+ 5.8	Q3	+ 0.6	Nov	+ 4.6	Jan	+ 1.5	Oct	− 1.7	Q3	14.6	Jan
Mexico	+ 2.7	Q4	+ 2.7	Dec	+ 3.9	Jan	− 7.6	Dec	− 8.4	Q3	74.1	Dec
Peru	+ 7.4	Dec	+ 7.6	Nov	+ 1.9	Jan	+ 5.1	Dec	+ 0.8	Q3	13.2	Dec
Venezuela	+10.2	Q4	+13.5	Dec	+13.1	Jan	+28.2	Q3	+21.6	Q3	23.4	Nov
Egypt	+ 5.2	Q1	+ 4.0	2005†	+ 3.1	Dec	−11.3	Q3	+ 1.8	Q3	20.8	Jan
Israel	+ 4.8	Q4	+ 7.0	Dec	+ 2.7	Jan	− 8.4	Jan	+ 2.4	Q3	28.3	Jan
Saudi Arabia	+ 6.5	2005‡	na		+ 1.1	Nov	+84.6	2004	+51.9	2004	26.5	Dec
South Africa	+ 4.9	Q3	+ 6.2	Dec	+ 4.0	Jan	− 2.8	Dec	−10.3	Q3	19.9	Jan
Czech Republic	+ 4.9	Q3	+ 7.1	Dec	+ 2.9	Jan	+ 1.8	Dec	− 3.4	Q3	29.5	Jan
Hungary	+ 4.1	Q4	+12.9	Dec	+ 2.7	Jan	− 3.4	Dec	− 8.7	Q3	20.1	Jan
Poland	+ 3.7	Q3	+ 9.5	Jan	+ 0.7	Jan	− 2.9	Dec	− 4.8	Dec	39.8	Dec
Russia	+ 7.0	Q4	+ 4.4	Jan	+10.6	Jan	+120.1	Dec	+81.2	Q3	181.4	Jan
Turkey	+ 7.0	Q3	+ 8.6	Dec	+ 7.9	Jan	−42.9	Dec	−22.3	Dec	50.5	Dec
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+10.8	Q3	+14.3	Dec	+ 4.7	Jan	− 2.5	Nov	− 1.4	Dec	1.9	Dec
Latvia	+11.4	Q3	+ 7.9	Dec	+ 7.5	Jan	− 3.0	Dec	− 2.0	Dec	2.2	Dec
Lithuania	+ 8.2	Q4	na		+ 3.5	Jan	− 3.6	Dec	− 1.8	Dec	3.7	Dec
Slovakia	+ 7.5	Q4	+ 8.7	Dec	+ 4.1	Jan	− 2.4	Dec	− 2.9	Oct	14.9	Dec
Slovenia	+ 3.7	Q3	+ 5.5	Dec	+ 2.4	Jan	− 1.7	Dec	− 0.3	Dec	7.9	Nov

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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Financial markets

Feb 23rd 2006
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Feb 22nd		Dec 31st 2004	
	Feb 22nd	year ago	Feb 22nd	% a year		one week	in local currency	in $ terms
China	8.05	8.28	14.0	2.25	1,347.0	-1.1	+ 1.3	+ 4.1
Hong Kong	7.76	7.80	13.5	4.12	15,635.7	+1.4	+ 9.9	+ 10.0
India	44.6	43.6	77.5	6.67	10,224.3	+1.1	+ 54.9	+ 51.1
Indonesia	9,355	9,210	16,278	13.76	1,231.3	-0.5	+ 23.1	+ 22.1
Malaysia	3.72	3.80	6.47	3.28	924.4	-0.3	+ 1.9	+ 4.0
Pakistan	60.0	59.4	104	9.07	11,446.3	+1.7	+ 84.1	+ 82.1
Philippines	51.9	54.7	90.2	7.38	2,067.9	-0.3	+ 13.4	+ 22.8
Singapore	1.63	1.63	2.84	3.38	2,427.9	+0.2	+ 17.5	+ 17.5
South Korea	975	1,004	1,696	4.27	1,340.6	+2.8	+ 49.6	+ 58.9
Taiwan	32.6	31.2	56.8	1.65	6,530.7	-1.0	+ 6.4	+ 3.3
Thailand	39.5	38.4	68.8	4.70	728.6	+0.4	+ 9.1	+ 7.1
Argentina	3.07	2.93	5.34	8.50	1,728.2	+3.5	+ 25.7	+ 21.6
Brazil	2.15	2.58	3.73	17.29	38,246.4	+2.7	+ 46.0	+ 80.7
Chile	519	567	902	4.56	9,637.8	+1.0	+ 7.5	+ 15.2
Colombia	2,253	2,309	3,921	6.06	11,063.7	+3.7	+154.6	+165.8
Mexico	10.5	11.1	18.3	7.48	18,780.5	+3.4	+ 45.4	+ 54.3
Peru	3.28	3.26	5.70	3.82	6,075.9	+3.0	+ 63.8	+ 63.8
Venezuela	2,677§	2,860§	4,657	10.37	27,248.8	+2.5	- 9.0	- 12.4
Egypt	5.74	5.80	9.99	8.05	60,290.6	-2.1	+145.2	+159.3
Israel	4.72	4.36	8.22	5.22	810.9	-1.4	+ 25.9	+ 15.2
Saudi Arabia	3.75	3.75	6.53	5.31	20,352.2	+2.5	+148.0	+148.0
South Africa	6.10	5.82	10.6	7.20	19,684.5	+5.1	+ 55.5	+ 43.6
Czech Republic	24.0	22.7	41.8	1.92	1,561.5	+2.8	+ 51.3	+ 40.7
Hungary	213	184	371	6.15	23,407.7	+5.8	+ 58.8	+ 34.5
Poland	3.19	2.99	5.56	4.18	39,128.3	+2.7	+ 46.9	+ 37.7
Russia	28.2	27.8	49.1	12.00	1,465.6‡	+6.6	+143.0	+138.7
Turkey	1.33	1.35	2.31	14.63	46,265.4	+5.6	+ 85.3	+ 88.5
EM (MSCI)*	1.00	1.00	1.74	na	779.1	+2.2	+ 43.7	+ 43.7
EMBI+†	1.00	1.00	1.74	na	379.7	+0.5	+ 15.2	+ 15.2

*Emerging Mkts. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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